

**OWNERSHIP WITH CHINESE CHARACTERISTICS:
PRIVATE PROPERTY RIGHTS AND LAND RE-
FORM IN THE PEOPLE'S REPUBLIC OF CHINA**

ROUNDTABLE
BEFORE THE
**CONGRESSIONAL-EXECUTIVE
COMMISSION ON CHINA**
ONE HUNDRED EIGHTH CONGRESS
FIRST SESSION

FEBRUARY 3, 2003

Printed for the use of the Congressional-Executive Commission on China



Available via the World Wide Web: <http://www.cecc.gov>

U.S. GOVERNMENT PRINTING OFFICE

86-630 PDF

WASHINGTON : 2003

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2250 Mail: Stop SSOP, Washington, DC 20402-0001

CONGRESSIONAL-EXECUTIVE COMMISSION ON CHINA

LEGISLATIVE BRANCH COMMISSIONERS

House

JIM LEACH, Iowa, *Chairman*
DOUG BEREUTER, Nebraska
DAVID DREIER, California
FRANK WOLF, Virginia
JOE PITTS, Pennsylvania
SANDER LEVIN, Michigan*
MARCY KAPTUR, Ohio*
SHERROD BROWN, Ohio*
JIM DAVIS, Florida*

Senate

CHUCK HAGEL, Nebraska, *Co-Chairman*
CRAIG THOMAS, Wyoming
SAM BROWNBACK, Kansas
PAT ROBERTS, Kansas
GORDON SMITH, Oregon
MAX BAUCUS, Montana
CARL LEVIN, Michigan
DIANNE FEINSTEIN, California
BYRON DORGAN, North Dakota

EXECUTIVE BRANCH COMMISSIONERS

PAULA DOBRIANSKY, Department of State*
GRANT ALDONAS, Department of Commerce*
D. CAMERON FINDLAY, Department of Labor*
LORNE CRANER, Department of State*
JAMES KELLY, Department of State*

JOHN FOARDE, *Staff Director*
DAVID DORMAN, *Deputy Staff Director*

*Appointed in the 107th Congress; not yet formally appointed in the 108th Congress.

CONTENTS

	Page
STATEMENTS	
Randolph, Patrick A., professor of law, University of Missouri at Kansas City, Kansas City, MO	2
Schwarzwalder, Brian, staff attorney, Rural Development Institute, Seattle, WA	6
Dorn, James A., vice president for academic affairs, the Cato Institute and editor, the Cato Journal, Washington, DC	9
Cohen, Mark A., attorney-advisor, U.S. Patent and Trademark Office, Washington, DC	13
APPENDIX	
PREPARED STATEMENTS	
Randolph, Patrick A	28
Schwarzwalder, Brian	33
Dorn, James A	37
Cohen Mark A	40

OWNERSHIP WITH CHINESE CHARACTERISTICS: PRIVATE PROPERTY RIGHTS AND LAND REFORM IN THE PEOPLE'S REPUBLIC OF CHINA [PRC]

MONDAY, FEBRUARY 3, 2003

CONGRESSIONAL-EXECUTIVE
COMMISSION ON CHINA,
Washington, DC.

The roundtable was convened, pursuant to notice, at 3 p.m., in room 2168, Rayburn House Office Building, John Foarde [staff director] presiding.

Also present: Jennifer Goedke, office of Representative Marcy Kaptur; Susan Weld, general counsel; Andrea Worden, senior counsel; Keith Hand, senior counsel; Selene Ko, chief counsel for trade and commercial law; Steve Marshall, senior advisor; Chris Billing, communication director; Anne Tsai, specialist on ethnic minorities; Lary Brown, specialist on labor issues; and William Farris, senior specialist on Internet issues and commercial rule of law.

Mr. FOARDE. Welcome to the second of the staff-led public issues roundtables for the calendar year 2003 of the Congressional-Executive Commission on China.

My name is John Foarde. I am staff director of the Commission. With me we have colleagues from both the Commission staff and the personal staffers to our Commission members, seated mostly at the other end of the table. I will be introducing you to them a bit later in the program.

The topic of our conversation today is "Ownership with Chinese Characteristics: Private Property Rights and Land Reform in the PRC." Our session today is scheduled until 4:30 p.m., but we may extend the discussion a bit.

Professor Randolph will be our first speaker, as he is going to have to leave about 4:30 to make his flight back to Kansas City. So, we will bid him adieu when that time comes, but in the meantime we will look forward to hearing from him and benefiting from his expertise.

Copies of the prepared witness statements are at the back of the room on the distribution table, and they will be available on the Commission's Web site. That is *www.cecc.gov*.

As usual with our issues roundtables, a full transcript of the roundtable will be available on the Web site in between 4 and 5 weeks. It takes us a few days to get the transcript back and to circulate it to our panelists and to our colleagues and the staff so that

they can make grammatical corrections and we can clean up the record. That is why it takes a bit longer than we would like.

We have four distinguished panelists with a wide range of experience in law in China. They are Patrick Randolph, professor of law at the University of Missouri at Kansas City [UMKC]; Brian Schwarzwald, staff attorney for the Rural Development Institute [RDI] in Seattle, WA; James Dorn, vice president for academic affairs at The Cato Institute and editor of The Cato Journal, from here in Washington, DC; and Mark Cohen, an attorney-advisor with the U.S. Patent and Trademark Office. I will tell you a little bit more about each before they speak.

Each speaker will have 10 minutes to give us a presentation. And we hope we can pick up the themes in their presentations in the question and answer session later.

So, without further ado, let us begin with Patrick Randolph. Pat is a professor of law at UMKC. He is an expert in property law and has a long experience working in China. He is co-author of a book entitled "Chinese Real Estate Law" and he was recently named co-director of the Peking University Center on Land Law and Policy.

Pat, please go ahead.

**STATEMENT OF PATRICK A. RANDOLPH, PROFESSOR OF LAW,
UNIVERSITY OF MISSOURI AT KANSAS CITY, KANSAS CITY, MO**

Mr. RANDOLPH. Thank you for having me here today. I am, essentially, a dirt lawyer, an American dirt lawyer. I have spent most of my life doing real estate law and commenting on being an American.

About 10 years ago, I got interested in Chinese real estate law during a visit there, and since then have spent quite a lot of time watching Chinese real estate law develop as best it could on the heels of, rather than in advance of, all of the real estate development that is happening in China. Chinese real estate law is doing a job of catch up. I find it fascinating to watch, and I hope in my heart that the law will eventually catch up and lead real estate development in China. I think that there is optimism about that. I am happy to talk to you about some of those issues today.

I think one of my functions is to give you something of an overview of the basis of China's real estate law. Essentially, until 1988, this was real estate law in China: the state owns everything, and you can stop there.

In 1988, the Constitution was amended to create the concept of the transferable interest in property that could be privately owned and transferred. This interest was called the Granted Land Use Right.

As I said, it has existed since 1988. And some laws were developed even prior to that time that referred to it, and certainly after that time, but because of other political problems in China, the economy slowed down and development slowed down for a while. It was not really until the early 1990s that we saw real estate development take off and with it, the need for greater development of the regulatory system for real estate.

The basic building block of the Chinese system that granted land use rights is a term of years in American terms. The term lasts from between 40 to 70 years, depending upon the right. You buy

it up front. So, it really is not like a lease when you pay rental payments periodically. You get it up front.

Perhaps the most significant difference between the Chinese concept and the American concept is that the Chinese are very powered on speculation in many areas, including this one. Consequently, when you apply for a land use right, you have an identified purpose to which you are expected to put it, and you must put it to that purpose within a short period of time—I believe the time is 3 years—or else you forfeit the right and anything you paid for it.

So, it is a rather draconian penalty for failure to develop the property. This requirement is met with various arrangements, but I think that it is a reasonably severe consequence and certainly drives a lot of Chinese real estate investment.

As I suggested, a transferable real estate right is not only transferable, but also mortgageable and inheritable. You can lease property that is on a granted land use right. And so, we have a complete system of real estate development and transfers based upon this term of years.

Now, this is not all that unusual as compared to the American system today. Today, shopping centers and office buildings, many downtown areas, are completely are given over to long-term ground use. I believe that probably a substantial portion of the State of Hawaii also is given over to ground leases and, in many parts of Pennsylvania, substantial areas are given over to long-term ground leases. So, this is not an unusual concept in the West. It is certainly possible to have a viable development system with this kind of a base.

Now, do we have one in China? As I suggested, the problem in China has been one of “playing catch up.” I think it is best to discuss it in connection with the three major areas of real estate development.

The first is commercial real estate. We have seen this development happen in the urban and suburban areas. Development started first in these areas when real estate regulation affected these areas first.

There has been substantial investment. Anybody who has been to China must recognize that. The basis for the development, however, has been somewhat different from that which we have known in this country. Consequently, maybe it is not as much a dependence on some of the laws that we see as significant here. The reason for that is that a great deal of investment in China is equity investment.

There is not that much lending as compared to the amount of investment that goes on. The equity investment is done by the expatriate Chinese, by government entities in other parts of China investing in the major urban areas. They say large portions of the Pudong, for instance, are owned by the county and city governments of various parts of China.

The characteristic of having equity owned properties is that they are not as vulnerable to economic cycles, because the people who own the properties can just hang in there. They are not beholden to the banks. Another characteristic is that they do not have to worry quite so much about the vulnerability of banking systems

and failures of them, at least with respect to the buildings themselves, although the businesses in those buildings, of course, may be operating on borrowed funds.

But a negative characteristic is that—well, I think in this country, one reason that our real estate system is so sound and our system of real estate regulation is the predictability that we have about behavior in the system and the accuracy of our land records, all as a consequence of lenders who are very risk averse and require high standards on the transactions on which they lend.

We are not seeing that as much in China as we would in the United States at the same level of development, and, furthermore, I think that not as much as we probably will in the future. I suspect that we will not see as much equity investment as the Chinese system becomes reliable enough to attract lending capital.

I think the biggest test, nevertheless, for the commercial real estate system is, as for any legal system, what happens when the bubble bursts? Anybody who has done business in this country in the real estate area knows that it is a reciprocal market. There is a demand. The demand, then, is met on a time line that is 5 or 10 years in development.

And by the time all the demand has been met, it has been over met, and we have a surplus of supply. We are starting to see that in certain cities in China. Sooner or later, just as we have in this country, we will have major real estate bubble bursting. And the question is, whether the legal system, which really is not as strong and as predictable as we would like, will be able to track the price, protect the investments when there is not enough money to go around.

It is quite easy to make mistakes and to patch them up when the property is on an upward track. It is quite different when there is not enough money to go around.

In the last 3 or 4 years, we have seen massive development in residential real estate in China, perhaps unprecedented anywhere in the world, at any time in the world. To listen to the real estate executives in China talk, they are telling us that 80 percent of urban Chinese now own their own home. That is a much higher percentage than the number of Americans who own their own homes. Or if not much higher, that is higher.

I am dubious about the number, but I think there is no question that an extraordinary number of Chinese people in the last 4 years have moved from housing that was not their own into housing for which they do have a land use right or participate in a land use right on a more or less condominium basis.

What I find intriguing about this development is that it promises the possibility of a sense of ownership, a sense of individual autonomy for an individual Chinese citizen, that, perhaps, has not been experienced by a individual Chinese citizen of the middle class or a lower middle class person at any time in Chinese history. And I think the ramifications of this kind of sense of autonomy for the development of a sense of political awareness, and eventually, a development of a demand for human rights coming from the Chinese citizens internally is quite gratifying and quite promising. And I really hope we see that start to occur, and I do have some suggestions I can talk about later as to how that might be assisted here.

With respect to rural real estate, one of my colleagues on this panel will address that issue. All I would say, again, is the development that has occurred only in the last 1 or 2 years, that we are seeing massive conversion of property that had been traditionally put over to the household responsibility system. It has begun to converge into some other kinds of ownership and other kinds of development with very little evidence that the peasants, the people who originally had control over these lands, are benefiting from these conversions.

And that is a matter of terrific concern to me, and I believe it to be a matter of great concern to the Chinese. I know there has been a recent new development in the legal system concerning that.

I want to make one more quick point, which is that it is important for anyone who thinks about Chinese law and the development of Chinese law to understand that legal power in China is widely distributed. The popular U.S. image of the all-powerful monolithic central government—this is not an accurate picture of China in the area of economic rights.

It is one thing to say that where local, county, and provincial government overlords have interests that are parallel with those of the national government, there seems to be a strong enforcement of the will of the national government. All of these people have an interest in power, and where they coincide, the power is going to come down very hard on the neck of the average citizen.

However, when we are talking about economic interests, the local and provincial governments have profits in mind. And there is no question that their interest in maintaining autonomous control over development and the rules that govern that development often conflict with the interest of the national government in having a transparent, predictable legal system that, basically, is the rule of law. And so, I think that if we do not see rule of law in some of the rural areas, we are disappointed in the performance of the Chinese legal system with respect to protection of individual investors' rights and property rights.

But we have to be concerned that we not necessarily hold the central government policies to blame for that. There is a great deal of distributed power within the Chinese system.

[The prepared statement of Mr. Randolph appears in the appendix.]

Mr. FOARDE. Pat, thank you very much.

I neglected to mention that my colleague, Mark Christopher, who is sitting in the second row, will keep us all on the straight and narrow when it comes to time, by giving you a warning when you have 2 minutes left, and then holding up a red card when your time is up. We will all try to stay very close to that.

Our second speaker this afternoon is Brian Schwarzwald, staff attorney with the Rural Development Institute. As RDI's China Program coordinator, Brian has managed two nationwide, random sample surveys monitoring implementation of ongoing rural land tenure reforms in China.

He has also assisted Chinese policymakers and legislative drafters in developing and implementing several laws, including the recent Rural Land Contracting Law.

Brian comes all the way from Seattle. Thanks for coming out here.

**STATEMENT OF BRIAN SCHWARZWALDER, STAFF ATTORNEY,
RURAL DEVELOPMENT INSTITUTE, SEATTLE, WA**

Mr. SCHWARZWALDER. Thanks, John. I would like to, first of all, thank all of the members of the Commission for giving me the opportunity to speak here today.

I would like to start by giving a very brief introduction to my organization and then touching on some of the highlights of my written statement.

RDI is a nongovernmental land law and policy institute, as John mentioned, located in Seattle. We have a total of nine attorneys working on land law reform in a number of different countries. China is our main program.

We have been involved in China since 1987. In the past 15 years we have conducted over 800 direct, very detailed interviews with farm households in over 20 provinces around China. As John mentioned, we have collaborated with Chinese research partners in designing and analyzing two large-scale, random-sample surveys.

I think most followers of China are aware of the impact of decollectivization of agriculture under the Household Responsibility System in the early 1980s, specifically, the increase in agricultural productivity and improvements in farmer well-being that resulted from the ability to cultivate individual plots, rather than working collectively. But I think even the closest observers of China are probably not aware of a recent series of law and policy reforms that are designed to fundamentally transform the nature of agricultural land rights that are held by farm households.

Under the Household Responsibility System, ownership of rural land was retained by the collective farmer communes, typically at the village level. Farm households were allocated the right to a proportional share of village land, based on each household's population.

Now, this type of collective ownership of household rights has been the predominant form of land tenure in China for about the last 20 years. But unlike the urban land use rights that Professor Randolph was discussing, rural land rights have been insecure and have not been easily marketable.

About 80 percent of Chinese villages adopted a practice of periodically reallocating land among households to reflect population changes within the village. Under these land readjustments, what happened was households whose populations had decreased lost land, and that land was given to households whose population had increased, as a way of maintaining an overall equality among households in the village.

The result was that no farmers could be certain of how long they would remain on any given parcel of land. So, in our interviews with farmers over the course of many years in China, they consistently told us three things.

One is that land readjustments constrained long-term investments in land. They were not willing to make an investment if they were worried that someone else would benefit from that investment

if the land were taken away from them through a land readjustment.

The second was that the uncertainty created by land readjustments made land transactions very difficult. Again, people were unwilling to take on rights to land if they were worried that it could be readjusted away during the term of the transfers.

And last, farmers told us that they preferred longer term rights to land. The recent reforms take very significant steps toward providing farmers with the long-term, secure rights that they have indicated they would prefer over the uncertainty of the land readjustment regime.

Most important under these reforms is the adoption of a new Rural Land Contracting Law by the National Peoples' Congress in August of last year. The law stops short of giving farmers full private ownership of their land. But the rights that it creates embody many of the important characteristics of private property rights. I just want to highlight some of the main features of the law.

Under the law, farmers are entitled to receive 30-year use rights to land, backed by a written contract and a land use certificate. Most important, the land during the 30-year term should remain free from land readjustments in all except very rare circumstances.

The law also provides protections for women's rights under the new "no-readjustment" regime. Women will be particularly vulnerable to losing land under a "no-readjustment" regime, because they are most likely to leave the household upon marriage, and may not receive an allocation of land in their new village under a "no-readjustment" policy. So, it is important that, for the first time, this law specifically addresses the issue of women's rights.

In terms of marketability, the law allows a broad range of transactions, including lease, transfer, exchange, and assignment, assignment being a transfer of the full remaining term.

A priority right is created for members of the village in which the land is located. But transfers to nonvillagers are also allowed under the law.

Transfers and assignments are treated somewhat differently. A transfer of less than full remaining term does not require any approval by the collective land owner. Whereas, an assignment of the full remaining term, essentially the equivalent of a sale in our system, does require approval of a collective land owner.

Under previous laws and policies, the rules governing all types of transactions were very unclear. So, these new guidelines should really provide the basis for the development of a market in long-term transfers of rural land use rights.

In terms of the rule of law, I think the Rural Land Contracting Law will also make important contributions to strengthening the rule of law in China's rural areas. Chapter IV of the law provides farmers for the first time with actionable claims against collective officials who violate their land rights. It does this by listing, very specifically, a set of prohibited actions, and then imposing strict civil penalties on anyone who violates those rules.

It also envisions equitable relief for farmers. That is, they can forestall future activities or undo violations of their land rights after they have occurred.

And in terms of resolving disputes that occur between farmers and collective officials, the law gives farmers the choice of a menu of different dispute resolution options, including consultation, mediation, arbitration, or direct filing suit in the People's Court.

I think there are a couple of very important implications of the law. The bottom line is that effective implementation of these rights will provide farmers with the incentive to increase productivity and to diversify production on their land.

True 30-year rights are long enough for farmers to recover the value of almost any type of agricultural investment over the course of the term, including planting of long-term crops, such as tree orchards.

Equally important, these secured, marketable rights will bring to life dead capital that is tied up in China's rural land.

From field work that we have done in comparable Asian countries—and by that I mean countries that are in similar stages of economic development to China and have similar population pressure on land—our estimate is that 30-year rights will attain a short-term value of somewhere between USD \$3,500 and USD \$4,500 per hectare. That is even discounting the fact that use rights are not equivalent in value to ownership rights, which are found in other Asian countries. So, if that level, that average value is achieved in China, that represents a total value for all rural land of somewhere between USD \$500 billion and USD \$600 billion.

So, placing that wealth in the hands of farmers will have profound impacts on rural China's economic, political, and social development over the long term.

Implementation of the law, of course, represents an enormous challenge. We are talking about close to one million natural villages across China. So, it will be a long-term process.

There are some recent statements from the Central Government in Beijing that are encouraging with respect to implementation. Both President Hu Jintao and Premier-to-be Wen Jiabao spoke at the recently concluded Rural Work Conference, and their statements seemed to indicate an overall increase of importance on rural issues, and particularly with respect to implementing the Rural Land Contracting Law, which was listed as the top priority for rural work in the coming year.

But as Professor Randolph mentioned, in cases where local interests do not match up with national interests or central government interests, there is likely to be resistance among local officials in many areas. This is certainly true of implementation of the Rural Land Contracting Law. Local officials consider land to be an important source of both wealth and power, and are likely to resist implementing reforms that give farmers greater power and lessen the ownership right.

So my organization, together with a number of Chinese partners, plans to stay very closely involved in a variety of implementation-related activities that are outlined in my written statement, but that include publicity for the new law, educating farmers with respect to what their rights are, monitoring implementation through additional field work and surveys, drafting province level implementing regulations, and over the long-term, developing a system

of supporting institutions that will help farmers enforce their new rights.

Thank you very much.

[The prepared statement of Mr. Schwarzwald appears in the appendix.]

Mr. FOARDE. Brian, thank you. It sounds like fascinating work. We will hear some more about it in the Q and A, I am sure.

Our next panelist is Dr. James Dorn, vice president for academic affairs at the Cato Institute, and editor of the Cato Journal. Jim is an economist and a China specialist. He has written copiously and well on economic reform and financial institutions in China, and has edited 10 books, including "China's Future: Constructive Partner or Emerging Threat," and a book called "Economic Reform in China."

Jim, welcome, and thank you for coming today.

STATEMENT OF JAMES A. DORN, VICE PRESIDENT FOR ACADEMIC AFFAIRS, THE CATO INSTITUTE AND EDITOR, THE CATO JOURNAL, WASHINGTON, DC

Mr. DORN. Thank you very much. Good afternoon. I would like to thank the Commission for this opportunity to address the issue of property rights in China, especially the pace of enterprise privatization, capital-market liberalization, and the implications of ownership reform for human rights and civil society.

Those issues are extremely important both to China and for United States-China relations. The primary goal of the fourth generation leaders of China is basically to maintain strong economic growth and increase prosperity throughout China.

However, to do so, they will have to confront a number of serious problems, particularly, the debt-ridden financial system and the inefficiency of state-owned enterprises [SOEs]. China's big four state-owned banks are technically insolvent, with nonperforming loans estimated to range from 25 to 40 percent or more of outstanding loans. The SOEs, that is, the state-owned enterprises, account for more than two-thirds of all bank loans in China, but produce less than one-third of the total value of industrial output.

That massive waste of capital under China's socialist market economy cannot be stopped without fundamental reform. The biggest problem facing China today is the problem of financial instability. What needs to be done, I would argue, is wide-scale, or wide-spread, privatization and the implementation of the rule of law.

China's largest SOEs remain under firm control of the government, but many medium and small-sized SOEs, up to 300,000, have been restructured or are being restructured. Moreover, since 1978, Beijing has allowed experimentation with different forms of ownership. They should be congratulated for doing so. Today, there are more than 20 types of ownership forms, including private firms, collective firms—for example, township and village enterprises, many of which are now private—joint stock companies, and foreign-funded enterprises, which play a huge role in the dynamic nonstate sector.

The exact scope of the private sector is difficult to estimate or calculate because private firms often conceal their true identity.

The law in China is very gray. It is not a black and white picture. So, firms often conceal their true identity, that is, “wear a red hat,” in order to gain access to state bank loans at subsidized interest rates, or to obtain other state favors.

The private sector receives only one-half of 1 percent of all state bank credit in China and is heavily discriminated against. That is why private firms conceal their true identity.

A reasonable estimate is that the private sector now accounts for one-third of China’s GDP. Private entrepreneurs, however, have to go to the informal sector to find funds, which is often illegal—that is, many forms of credit allocation in the informal sector are illegal.

Private and cooperative enterprises have been extremely successful over the past 25 years and now account for more than two-thirds of the value of industrial output.

The dynamic sector, to re-emphasize, has been the nonstate sector, which includes private firms as well as collective firms and other types of firms. Their success has resulted in official recognition. Article 11 of the Chinese Constitution, which was amended in 1999, now reads, “Individual, private and other nonpublic economies that exist within the limits prescribed by law are major components of the socialist market economy.” Who would ever have thought that such a statement would appear in the Chinese Constitution?

Private firms were illegal in 1978, and SOEs dominated the economic landscape. Today, there are nearly 2 million private enterprises employing more than 24 million workers, as stated in the “Statistical Yearbook.”

The number of private enterprises is growing by more than 30 percent per year, especially in the coastal areas. Much of the growth of the private sector has been spontaneous, in the sense that privatization took place without central direction by leaders in Beijing, as opportunities for local leaders and entrepreneurs increased—that is, as trade opportunities increased, especially in the special economic zones.

Local jurisdictions were allowed to experiment with new ownership forms. When they were successful, others sought to imitate that success. Like politicians everywhere, China’s politicians like to imitate success. The central government initially did not fully support the nonstate sector.

Only later did Beijing put its stamp of approval on the institutional innovations, which is why I like to call the development of the private sector “spontaneous privatization.”

The growth of the private sector, or private enterprise, occurred despite the lack of transparency in the legal regime and despite the severe restrictions on access to state bank credit, which shows the ingenuity of the Chinese people.

Informal private capital markets have evolved to fund the private sector, and overseas Chinese have been an important source of investment funds for the foreign invested enterprises. Professor Kelly Tsai, who I list in the recommended readings at the end of my formal statement, has done an excellent job showing the importance of the informal financial organizations.

The strong performance of provinces with greater economic freedom, such as Fujian, Guangdong, and Zhejiang, has created a new

middle class and a demand for better government and more secure property rights. One can see this very clearly.

Capitalists are now free to join the Chinese Communist Party, and several well-known private entrepreneurs are already members of the National People's Congress. As more entrepreneurs join the Party, there will be mounting pressure, I believe, to change the status quo.

China's accession to the World Trade Organization [WTO] in December 2001 has resulted in a long-term commitment to economic liberalization and legal reform. The policy of engagement is working to change China's legal system and better protect property rights, and, hence, human rights. I think that is very important to recognize. For example, China's first civil code has just been drafted, including an entire chapter dedicated to the protection of private property rights.

China's top judge, Xiao Yang, president of the Supreme People's Court, has called for safeguarding private property rights, and told a national conference in Beijing recently, "Efforts should be made to enhance awareness of the need for equal protection of all subjects in the marketplace."

At the Chinese Communist Party's 16th National Congress held last November, President Jiang Zemin told the new generation of leaders, "We need to respect and protect all work that is good for the people and society and improve the legal system for protecting private property." That capitalist sentiment is from China's predominate leader.

Jiang's rhetoric should be taken seriously, I believe. Chinese citizens can now own their own businesses, buy shares of stock, travel widely, hold long-term land use rights, own their own homes, and work for nonstate firms. Although the depoliticalization of economic life is far from complete, the reforms thus far have created new mindsets, expanded individual choices, and given rebirth to China's civil society. Anybody that has been to China recently can see that.

Real reform, however, will require more than "revitalizing or recapitalizing" state-owned enterprises and state-owned banks; it will require a firm commitment to widespread privatization of state-owned assets. Until the government and party are shut out of banks and enterprises, corruption will continue and nonperforming loans will mount. What China really needs is not pseudo capital markets under market socialism, but real capital markets under market liberalism—markets in which shares are freely transferable and liquid, and that individuals trust.

Markets work best when property is fully protected by the rule of law and people are free to choose. We should not forget the words of James Madison, the chief architect of the U.S. Constitution, who said, "The personal right to acquire property, which is a natural right, gives to property, when acquired, a right to protection as a social right."

China is beginning to recognize the right to private property, but only as a right bestowed by the state, not as a natural, inalienable right. Consequently, private property can never be secure until there is a fundamental revolution in political philosophy that places the individual, not the state, at the center of the moral universe and limits the power of government.

The great Chinese philosopher Lao Tzu was right when he said, “When taxes are too high, people go hungry. When government is too intrusive, people lose their spirit. Act for the people’s benefit. Trust them. Leave them alone.” China’s leaders and people can turn to the writings of Lao Tzu for guidance in understanding the principle of nonintervention as the basis for spontaneous economic and social order.

Recent changes are encouraging. In addition to the ones already mentioned, the following are noteworthy: Qualified foreign institutional investors will soon be allowed to buy equity stakes in SOEs through the A-share—local currency—stock exchanges in Shanghai and Shenzhen; strategic foreign investors will be allowed, for the first time, to buy the nontradeable shares of listed and unlisted SOEs; private commercial banks are being established in rural areas; farmers will have more secure land use rights as a result of the Rural Land Contracting Law adopted in August 2002; and Shenzhen, the first special economic zone in China, is embarking on a bold political experiment with Beijing’s approval to limit the power of local cadres, introduce checks and balances, and cultivate the rule of law. It is no coincidence that this political reform would be introduced in one of the most marketized provinces in China.

Those reforms and others are being driven by the need to be competitive in an increasingly global economy. To attract and retain capital in the future, China will have to continue to improve its institutional infrastructure, not just its buildings, highways, and airports.

As China liberalizes its financial sector, removes remaining barriers to trade, and improves its legal structure, the range of choice for millions of Chinese will improve. That increase in economic freedom is sure to have a positive effect on creating what Liu Junning, an independent scholar in Beijing, has called, “a constitutional order of freedom in China.”

The United States can help transform China by continuing the policy of engagement, by ensuring that China honors its WTO commitments, as well as its bilateral trade agreement with the United States, and by adopting a more liberal visa policy that allows Chinese students and scholars, especially those in law, economics, and the humanities, to learn about and experience firsthand a free society.

Thank you very much.

[The prepared statement of Mr. Dorn appears in the appendix.]
Mr. FOARDE. Thank you very much, Jim.

Our final panelist this afternoon is Mark Cohen, attorney-advisor in the U.S. Patent and Trademark Office [USPTO] here in Washington. As an attorney with the USPTO, Mark’s responsibilities include training and consultations on standards for intellectual property enforcement, especially with respect to East Asia and South Asia. He has written extensively on Chinese intellectual property law since 1984, and most recently edited a volume entitled “Chinese Intellectual Property Law and Practice.” Before joining the USPTO, Mark was a managing partner of the Guangzhou, China, office of a U.S. law firm.

Mark, welcome and thanks for coming this afternoon.

**STATEMENT OF MARK A. COHEN, ATTORNEY-ADVISOR, U.S.
PATENT AND TRADEMARK OFFICE, WASHINGTON, DC**

Mr. COHEN. Thank you, John. It is a little bit humbling to talk after “dirt lawyers” and capital lawyers about intangible assets. I would like to thank the Commission for inviting me. As my friends know, I am always happy to talk about intellectual property rights [IPRs] in China, in any venue.

In recognizing the Commission’s role in monitoring compliance with human rights and rule of law in its implementing legislation, as well as its interest in WTO matters, the focus of my brief 10 minutes will be on the current state of protection of U.S. intellectual property rights in China and intellectual property and the rule of law. To a lesser extent, I will briefly highlight U.S. Government efforts to promote IP protection and the rule of law in China.

I would like to say at the outset that these comments are my own. They are not an official statement of U.S. Government policy. I am not sure, in some instances, whether there is an official U.S. Government policy on the relationship between rule of law and IPR. However, they are issues that are of longstanding interest to me, and they contrast with some of the issues that you have just heard today. I am talking about legally-created intangible assets, not tangible assets.

Unlike commercial property, IPRs have a well-defined, clear WTO context. IPR is also unlike land, where the primary constituency is China’s own citizenry. It seems very often when we talk about intellectual property, the primary, but not the only constituent, may be foreigners: foreign investors, and foreign holders of IPRs.

The protection of U.S. intellectual property in China was outlined in some detail in the December 11, 2002, report of the U.S. Trade Representative [USTR] to Congress on China’s WTO compliance. That report, and I think most of the people who testified in preparation for it stated that a large number of China’s laws on the books are basically WTO compliant. These laws basically meet the WTO minimum standard contained in the Trade-Related Aspect of Intellectual Property [TRIPS] agreement.

The clearest deficiency is enforcement. As explained by one trade association, “effective enforcement against IPR infringement in China is universally recognized as the chief concern of IPR rights-holders, as piracy rates in China in all areas, including copyright, trademark and patents, continues to be excessively high.”

One may wonder in looking at this current situation if this is not a case of “deja vu all over again.” This year marks the 100th anniversary of the first bilateral agreement between the United States and China, which was the 1903 “Treaty for Extension of the Commercial Relations Between China and the United States,” concluded at the end of the Qing Dynasty. There have been a succession of other agreements since then, including after normalization of relations with the People’s Republic of China in 1979.

During the past few years, we have seen a quickening of pace in China’s march toward conforming its IPR system with international standards. As noted, 20 years ago it may have been illegal to operate a private enterprise. All that we had at that time was a very rudimentary trademark law. Beginning with the 1980s, we

had a patent and a copyright law, and a host of other legislation on board.

Since WTO accession, China has ambitiously promulgated, revised, or annulled a very large corpus of legislation, regulations, and rules. I sometimes say that a job I would have least liked to have a year or two ago would be a legislator in China, because the number of revisions and changes was enormous. Yet, despite these legislative efforts, U.S. industry is facing daunting challenges in China's market to combat frequently illegal operations.

U.S. copyright industries report they are, in general, suffering a piracy rate of over 90 percent in the Chinese market, across the range of copyrighted products, including motion pictures, music, and software. Losses as reported in 2001 were in the range of \$1.5 billion due to piracy.

Of course, this is easily verified by sight observations by anyone who has been to China. At the Xiushui Market, near the U.S. Embassy, or at Luowu Market on the border of Shenzhen, pirated motion pictures, movies, and video games, and a range of counterfeit products are freely available for sale, sometimes to the exclusion of any legitimate product. In my presentation, there is a slide from the Xiushui Market, where you can see pirated products in full view of the authorities.

China's role as a manufacturer and consumer of pirated and counterfeit goods not only affects the market in China for U.S. products, it affects our own market, and it affects third-country markets. In the 1990s, this was most evident when China was a major exporter of pirated CD-ROMS. These exports have since largely come under control.

In the United States, the most objective data we have is the statistics of Custom seizures of counterfeit and pirated goods. For 4 out of the past 5 years, mainland China has been the leading supplier of seized goods, 49 percent last year. If you aggregate it and compound it with Taiwan and Hong Kong, it would be well over 50 percent. In the past 5 years, there was only 1 year in which mainland China was not in the first place.

However, U.S. statistics do not document the full extent of the harm caused by these exports. Industry experts and consumers report the presence of Chinese exports of products such as counterfeit aircraft parts, counterfeit car parts, even whole counterfeit cars and motorcycles. Many of these cases are multinational in nature. Some of them involve organized crime. A few years back, in April 1987, there was a case involving counterfeit bulk pharmaceuticals from China that were allegedly responsible for as many as six toxic reactions in Denver.

I am not saying that China is solely responsible for all of these things. In that case, a U.S. company, a distributor, was repackaging them. There have been a number of other criminal cases in the United States involving imports of Chinese counterfeit and pirated goods.

As IP crime extends beyond the national borders, it is important to note that the cooperation of Chinese colleagues in law enforcement and in IP protection is critical. This is not a one-way street. For example, pirated content may be located on a Chinese computer for which U.S. industry needs the cooperation of Chinese

authorities, as one example of the need to obtain evidence in multinational crimes.

In addition, IPR crimes have been linked in many cases to terrorist activities. A recent article in the *New Yorker* magazine noted that in Paraguay, the source of counterfeit products sold by terrorist groups is largely Chinese in origin. There have been other articles and anecdotal evidence.

Given this rather bleak situation, what does the future hold? History shows us, of course, that China had a long tradition before the Industrial Revolution of being a major innovator of new technology. I have already mentioned that China has committed significant efforts to reforming its laws as well as establishing a full range of administrative agencies. There are many signs that intellectual property is becoming more important to China.

In 2002, for example, China became the leading country in the world for receiving new trademark applications. In 2001, there were nearly 10 times as many Chinese applications for trademarks in China, compared to foreign applications. Although imperial China lacked a tradition of protection of IPR, Taiwan is the third largest foreign region applying for patents before the USPTO, my own agency.

So, there is a lot of positive news. As noted by previous speakers, there are also developing markets for intellectual property rights, and the government has been actively developing urban technology markets.

Among the other positive trends, criminal prosecutions, although small, are increasing. China's leadership has also indicated that intellectual property is of great concern. It is important to note that open markets, which we all looked forward to in WTO accession, do have an unfortunate side effect. They create a greater opportunity for counterfeiters and pirates to ply their wares.

Regarding rule of law, I believe intellectual property is the most vulnerable to ineffective legal systems of all property rights, as it is intangible. It is a right that is completely defined by law. It is important to note that China does not lack intellectual property laws. What China lacks mostly is deterrent enforcement of those laws.

China has a vast and rather complicated administrative apparatus for patents, trademarks, copyrights, semiconductor layout design, trade secrets, trade dress, defective products, illegal use of the Internet, counterfeit tobacco, and counterfeit drugs, all of which implicate intellectual property rights.

China has a specialized intellectual property court system. A frequent issue in dealing with intellectual property rights in China is determining which national or local law, rule, regulation, interpretation, decree, or decision, applies and is in actual effect.

In addition, because of the nature of the parallel system—you have civil, criminal, and administrative sanctions—there is also a question of which rule applies to which agency and to what extent. On the enforcement side, the lion's share of China's intellectual property enforcement is administrative, where there are tens of thousands of cases, compared to perhaps 5,000 civil cases and perhaps 100 or so criminal cases. By comparison, in the United States,

we had about 1,200 criminal cases for intellectual property rights on the Federal level alone for the year 2000.

The relationship between IP and rule of law was recently underscored at a roundtable in October 2002, where Ambassador Randt indicated that the only effective enforcement in China is going to come from overall legal reform. Some of those seeds for legal reform, to a certain extent, are found in the TRIPS agreement itself, which requires proportionality in criminal punishments in the context of IP crimes, and transparency in administrative and judicial decisionmaking, all of which have an important rule of law context.

As we seek more effective enforcement of China's IPR laws, civil, criminal and administrative, we should also be mindful of other U.S. Government policies in promoting a legal system that meets international standards of fairness. These goals are complimentary, not inconsistent.

Effective law enforcement can be a double-edged sword. With China's increase in domestic rights holders, including, for example, trademark holders as I just mentioned, there is a growing likelihood that U.S. companies will find themselves on the wrong end of enforcement actions, frivolous or otherwise. Thus, it is in the interest of the U.S. Government, as well as U.S. companies, to promote the development of a legal system in China that fairly protects the rights of all parties and has reliable fact-finding processes.

The last thing I want to briefly mention is U.S. Government efforts to promote intellectual property protection. One of the two key issues that we are facing this year and the years ahead is criminal enforcement. Because of the widespread deterrent effect of criminal prosecution, and because of those TRIPS obligations, and also because of the general lack of awareness of IPR crimes by police officers and prosecutors in many countries, training law enforcement officials is a worldwide task and one that is very important for the U.S. Government to develop.

The U.S. Sentencing Guidelines, in particular, have elicited considerable interest from Chinese colleagues because they provide a reasonable, fair, and proportional method for determining sentences for IPR infringers, which is consistent with international practices, and I believe also advances our goals for the rule of law, including issues such as controlling local protectionism. It is likely this year that there will be increased training in China on IPR criminal issues.

Another emerging issue of some importance, is Internet copyright. As we all know, Internet usage in China is increasing dramatically. By some statistics, the Chinese language will be the predominant language on the Internet in the years ahead. Copyright protection over the Internet, as well as other forms of digital issues involving copyright, are increasingly important internationally.

While China's recently revised copyright law and other regulations and interpretations do consider the impact of the Internet on copyright protection, the U.S. Government would like China to accede to the most important recent treaties of the Internet, the World Intellectual Property Organization [WIPO] Internet Treaties, namely the WIPO Copyright Treaty, and the WIPO Performance

and Phonograms Treaty. We would also like China to more vigorously coordinate and enforce copyright in digital formats. More training in this area is also needed.

Thank you very much. I look forward to your questions.

[The prepared statement of Mr. Cohen appears in the appendix.]

Mr. FOARDE. Four fascinating presentations by four experts on four different aspects of this important issue.

I would like to start out the questioning, because time is short, and just ask one. I think this is for Pat Randolph, but perhaps someone else would like to step up to it.

Pat, what type of registration system of the land rights that are now available to Chinese citizens is in place, if any?

Mr. RANDOLPH. Yes. The system of public records for Chinese land rights is really quite well developed. It is called a registration system. Basically, the registration of the interest confirms the validity and existence of the interest. And so, actually, it gives far more protection of the rights to register than the U.S. system or European system.

One of the frustrations in past years has been the lack of access to registration records, particularly in outlying areas. It is very difficult to have an active market system where no one can figure out who owns the property or when only selected beneficiaries of land use can get that information.

In response to that, and I think a very encouraging response, in the last 6 months China has adopted national policies that require public access to registration records nationwide.

Mr. FOARDE. Very good. We are going to be starting out over here on the left side with my friend and colleague, Keith Hand.

Mr. HAND. Thank you all for your presentations.

Jim, you flagged China's financial crisis as the most pressing issue in China at the moment. I am wondering if there is any indication as to whether the government would consider sale of full ownership rights over the land, in part, to deal with this looming financial crisis. Or is that just too problematic ideologically?

Mr. DORN. Well, it is not really a question of ownership rights over the land. I think they are moving in that direction, as Brian pointed out. They expect to have fully transferable rights and markets for those property rights in the near future.

The real question for the state-owned enterprises, particularly the large SOEs in the urban areas, is how to expand private trading rights. Most of the stocks listed on the exchanges in China are nontradeable shares. They are held by asset management companies at different levels of government, and their true value is really unknown.

As a result of the small number of tradeable shares, the A-share market is highly overvalued. Placing nontradeable shares on the market would lower prices, and that is why it has been opposed.

Unless the Party and the government are divorced from ownership in those enterprises and SOEs are privatized, the incentive structure will not change. Managerial changes may help, but they will not cure the real problem, which is to value enterprises according to market criteria and to allow shares to be fully transferable.

The real barrier to privatization is political, because once SOEs are privatized Communism will be dead, and the Party will lose

much of its power. The Party is not homogeneous. There are some leaders who really want substantial reform, but they know privatization will be a death blow to the Party. There is a real dilemma, because the dynamic sector has been the nonstate sector, particularly foreign-funded enterprises and private enterprises.

I think China's main challenge, in the very near future, is how much privatization to allow. The leaders may not even call it privatization; they may call it marketization or some other term. So, one has to look at more subtle changes. And that is why I think the announcement by Jiang Zemin at the 16th Party Congress—that private property should be protected—is a very strong signal that things are not going to stay the same. We should welcome China's accession to the WTO because it will put pressure on the large SOEs to get into shape and give China's leaders a justification for further reform.

Mr. RANDOLPH. I think that with respect to residential real estate, it is widely anticipated in China that present 70-year-old land use rights will be converted to ownership rights before the end of the 70-year term. I think it is just a matter of time as the population starts to develop an awareness that they are investing in properties that they may not own for the duration of their lives or duration of their investment lives; that there will be pressure for this. And even today there is some conceit among the scholars and intellectuals of China that there is nothing inconsistent with socialist principles to permit people to own their own homes.

With respect to development property, I think the land use rights are shorter in this area, and I think potential profitability of recent land use rights at the end of their terms will prevent any conversion to ownership in the short term.

Mr. SCHWARZWALDER. On the rural land issue, in the past, essentially rural land was for agricultural purposes and has been worthless on the market. The lack of market development is one reason. Everyone now realizes that there is potential value in rural land. The question is, who is going to capture that value? Will it be the central government, the collective owners, or the farmers themselves?

I think, both from the experience of urban land rights reform and international experience, that I agree with Professor Randolph that there is going to be increasing pressure for privatization or extension of use rights.

There basically have been two proposals put forth by Chinese researchers on that point. One is to nationalize rural land, to take ownership away from the collective and give it directly to the state, or essentially, to follow the urban land system. The other is to fully privatize the land and sell it to farmers at a very low price to allow them to eventually realize the increased value on the market.

Both of those proposals basically, are in response to concerns that it is going to be the collective land owner who will capture the value of the land. There has been some momentum for the idea of nationalizing land, but so far, the idea of privatizing rural land really has not gained a lot of momentum.

At the time that 30-year rights would be implemented under the Land Management Law, which was adopted in 1998, President Jiang made a statement that at the end of the 30-year term, he

saw no reason why they should not be extended for an additional 30-year term. My sense is that it is very likely that prior to the end of this 30-year term, that it will be extended to 50 or 70 years, or perhaps perpetual use rights, potentially to full private ownership. But the rural sector will not lead the way. You won't get full private ownership of rural land until you have the transition to full private ownership of urban residential land that Professor Randolph was talking about.

Mr. FOARDE. Thank you. And thank you, Keith.

In the interest of balance, we are going to go way down to this end of table and recognize Jennifer Goedke, who represents Congresswoman Marcy Kaptur, one of our Commission members.

Ms. GOEDKE. I have two brief questions. One is for Mr. Cohen. You said that China does not lack for IPR rights. This the same for worker rights or internationally-recognized human rights. But implementation has always been a problem. Do you still consider China a trustworthy trade partner, even though they do not follow through with their own laws, let alone bilateral, multilateral trade agreements? Not speaking for your agency, of course, speaking for yourself.

Mr. COHEN. I do not know if the question is a matter of trustworthy or not trustworthy, because there are so many laws and rules and regulations on the books, that the sheer quantity suggests somebody is thinking quite seriously about intellectual property rights. I believe there are many people in China who are thinking quite seriously. The battle is to engage the right people on the right issues to advance our interests and to make them realize it is in their interests as well.

If you were to look at trustworthiness, for example, I think the weakest segment of the enforcement of intellectual property rights in China is copyright. And you could say that the reason for that is that they have the least engagement on that issue. The motion picture industry is suffering. Software is dominated by Microsoft and other U.S. makers. And also the music industry, although there is a native music industry, a lot of it is also imported and could have come from America.

So there seems to be the least strength in that segment. And that may be one of the reasons we have very tepid criminal enforcement to deal with widespread piracy in China. But, that being said, there are also some positive signs. And by the fact that the Chinese, themselves, are filing for separate forms of rights and trying to enforce them, hopefully, they will be enforced with full regard for national treatment, for Americans and foreigners being treated the same as Chinese. Those are all positive prospects.

Mr. RANDOLPH. I would like to make a comment also. With respect to China's attractiveness as a trading partner and the question of corporate laws, I think that it is very important—again, to keep in mind that where you wish to point your finger—I think there is concern, even in the economic area about uniform enforcement of laws. However, I do not think that is due to the lack of national policy concerning transparency of the legal system and enforceable rights in the commercial area.

I think the concern is breaking down the resistance to that kind of policy that might arise because of local interests. And I think

that the United States and China both cooperate in addressing that problem by attempting to produce and disperse legal expertise both among the lawyers and judges across China.

I think one of the problems we have is that Chinese law schools today are ginning out the lawyers by the fistful, but they are all staying in Beijing, Shanghai, Shenzhen, and Guangzhou. That is where the profits are to be made, they perceive. And there is very little dispersal of legal expertise across the country. Furthermore, how much of the judiciary is poorly educated. And because they are poorly educated and because there are no lawyers presenting legal arguments to them about what the law really is, they are really very much more exposed to pressure from local government enterprises.

Ms. GOEDKE. But, if a lawyer were to speak in opposition—we find so many people afraid to do so, fearful of additional attention, shall we say, from the government—is there an environment for a lawyer to take a different path?

Mr. RANDOLPH. I think there is certainly an environment for a lawyer to advocate economic interests of his or her clients. And I think that increasing activity in generating awareness of the existence of the laws and the national government support for them across China would be very helpful. I think there are too many seminars in Beijing and not enough seminars in the outlying areas.

I think we are at somewhat cross-purposes, because I am not going to argue with you about the issue of criminal justice or the issue of rights of free speech, or the disaffected Chinese who wish speak out in criticism of the government in rural areas. I do not think that it is a good place to be a dissident, nor is it a good place to get in trouble, but I do not think that is true with respect to advocacy of the economic interests of people or the economic system in China. I think that they are almost two systems existing parallel.

Mr. FOARDE. We will go back over to this side. Susan Roosevelt Weld is the general counsel of the Commission.

Ms. WELD. Thanks, John. I guess there is one thing that I have been thinking of while listening to all of you speak, actually two things: one is equity, and the other corruption. Brian, in the rural context, I wonder what your surveys tell us about whether this rule about women really raises the status of women in the land-use system in the rural area. How about minorities that might live in these villages? Are they getting the land-use rights just like everybody else, under the allocation made by the local collective? And where might they take their claims if they have a claim of lack of equity? So, that is the first part.

Mr. SCHWARZWALDER. We have not done detailed field work comparing rights that are given to minorities, as opposed to rights that are allocated to Han Chinese in individual villages, but we have done some field work, and our surveys did include some minority villages. And we have not discovered any lack of equity in that work. Essentially, the Household Responsibility System was one of the few reforms that really did reach all of China, including its heavily ethnic minority areas of northern Yunnan Province where we have done field work.

Traditional tenure arrangements still existed for grassland and forest land, but on agricultural land the 30-year right system had largely been implemented. In terms of women's rights, it is an issue that under the new law is going to require a good deal of attention in the future. There is the potential for women who leave their original village and take up residence with their husband's village, to essentially become landless. But what the law does is it preserves their right to a proportionate share of land in their original household until they are granted a share of land in their husband's household.

So, I think there are several steps that really are going to need to be taken to make that a valuable right. One is that we need to have a more detailed explanation in implementing rules of how that right is going to be asserted. And then you are going to need to educate women on how they can assert that right. And they are going to need to come up with a framework for asserting the right that works at the village level.

The development of markets is going to be very important in terms of women's rights, because I think the most likely outcome, and perhaps the most favorable outcome, will be the development of markets where the woman, at the time of leaving her original household, can realize the value of her proportionate share by transferring it, by separating it and transferring it from her original household, taking that wealth into her new household.

It is going to be a long-term process, the development of effective ways of asserting that right. But it is an area in which we have seen increasing awareness and increasing attention among legislatures and policymakers in Beijing.

Mr. RANDOLPH. I would like to address the issue. Well, actually, it is a separate issue.

As I indicated in my paper, ask any Beijing taxi driver what the number one problem is in China today, and he will tell you it is corruption. I asked that question 10 years ago, and they told me it was too many people. I asked it 5 years ago, and they said the environment is too polluted.

I think that is probably true in almost any urban area in China. People are sick and tired of corrupt public officials. And they want a change.

Now, this gives me encouragement, because if the average person on the street believes that they can speak out and say, "I am tired of corruption, and I want change," I think that is the first step for China moving in the area of effective change.

First, because the way these people find out about corruption is because of public notoriety about bases of corruption. The Chinese Government is permitting the population to become aware of corruption, because, at least at the national level, there is an attitude toward correcting this problem.

Second, I think that American policies that have permitted China, and Chinese policies that have permitted the people of China, to develop personal wealth and hope of improving their personal situation. They accepted the conclusion that if a person is getting a benefit because of a corrupt action, that is a benefit that I might have, or that my children might have. And it makes me mad.

Whereas, 20 years ago, someone would say, "Well more power to you. I could not have that anyway." So, I think that the upward mobility of the average Chinese leads to a far lesser tolerance of corrupt bureaucracy. I am not saying the problem is going to change overnight. It is very difficult to correct corruption and at the same time allow public access to information. I think the two issues are closely correlated. But I think there is a will in China to address the problem of corruption.

Mr. FOARDE. We will go way down to the other end of the table and recognize Selene Ko, our colleague who is senior counsel for commercial rule of law on the Commission staff.

Ms. KO. I have a quick question for Mark, about your comments that the beneficiaries of strong intellectual property protection go to, for the most part, foreign investors and foreign interests. You mentioned that there is at least growing awareness by the Chinese Government that there is a benefit to stronger intellectual property protection within China to Chinese citizens.

I was wondering if you would comment on the awareness among the Chinese public at large about the importance of intellectual property protection and whether there are domestic groups putting any sort of pressure on Chinese authorities to improve intellectual property protection?

Mr. COHEN. That is a very good question. There certainly are domestic Chinese constituencies or intellectual property protection organizations. The preeminent group consists mostly of foreign-invested companies. There is also a Chinese software group, Chinese musicians, and Chinese consumer groups, which are certainly advocates that the government listens to.

I think it is sometimes too much to expect of the average citizen in any country to know a great deal about intellectual property rights. They do know when they are being ripped off. They know when they are buying a shoddy product or a counterfeit product. I would like to see police in China knowing more about protection of property rights. Most policemen are, however, preoccupied with other types of crimes. There is so much of it in China, they should have more of a leading role. There is also Consumers' Day, which is coming up, I believe, March 14, or 15. There are activities involving counterfeit and shoddy goods. And we would like to see more advance notice of Chinese rules, with an opportunity to comment. I found that in telling Chinese about transparency, they recognize that it is very important in order to disseminate rules and inform the public. It is not the fact that they would be soliciting comments, but by publishing rules in advance, the public would be more aware of the rules and regulations. I think most of the local and national IP authorities are very much aware of their responsibility to disseminate their rules, so that certainly lower-level officials know, but also that the population knows that they should be concerned with those rules. It is a very important part of their responsibility.

You can frequently see this in training sessions. When we are conducting programs in the provinces, we find someone who is, obviously, quite skilled in talking about the law, because it is more or less his job to train and inform the public.

Ms. KO. Thank you.

Mr. FOARDE. Let me continue with a question to Jim Dorn.

You said a moment ago that among the positive factors that you were talking about are the changes that have gone on in China recently, where the entrepreneurs have been admitted to the Chinese Communist Party for the first time, and that you thought their entry and activity in the Party would change the status quo.

May I ask you to speculate a little bit about how that will happen? What is the dynamic of that?

Mr. DORN. Well, again, officially, capitalists were just admitted to the Party, but, unofficially, capitalists have been members of the Party for quite some time.

It is another good example of how things are changing in China spontaneously and, only later, are officially sanctioned. I think it is an admission by the leadership that the private sector is so important that they cannot afford to leave entrepreneurs out of the Party.

So, this is a victory for capitalism, or what I prefer to call market liberalism, because capitalism seems to be a politically loaded term in various countries these days. Of course, without a transparent legal system in China, individuals cannot make a lot of money in the private sector unless they "buy influence" along the way. Still, markets are opening and, in the next five years, the financial markets are going to open substantially. Moreover, with China's accession to the WTO, foreign firms are going to have direct distribution rights for the first time, which will be a tremendous advantage for those firms.

And this is going to force the state-owned enterprises in China to become efficient or possibly face bankruptcy. There is really no bankruptcy law in China at this point, but experts are working on it now. And when they start allowing a few of the large SOEs to actually fail, that will be another step toward a real market economy.

So, I think more and more private entrepreneurs will become members of the National People's Congress in the next decade. And the market-oriented coastal areas are going to have more and more influence in Beijing. As this happens, it is going to drive an increasing wedge in the Party between the old conservatives and the more reform-minded politicians.

So, I think this is a good thing.

Mr. FOARDE. Thank you, Jim. Let us go on to Andrea Worden, who has not yet spoken.

Ms. WORDEN. Thank you, John. I also have a question for Mr. Dorn. You mentioned that China is currently considering a new draft civil code. I am wondering if you have any specifics about the provisions that will enhance protection for private property rights, and also if you know what the time line is for the NPC's consideration of this new draft?

Mr. DORN. Right. That is a very good question.

I think the draft civil code is extremely important. It is the first new civil code since 1986. The 1986 general principles of civil law provide no effective protection to private property.

The new draft civil code has 9 sections, is about 216 pages, and has 1,200 clauses. It has an entire section on private property rights. The fact that, in the world's largest Communist country, there is a new draft civil code on private property rights is ex-

tremely important. Of course, we do not know whether the code will be enacted as drafted; most likely it will not. But, as entrepreneurs become Party members, they are going to push for better protection, so there is a good chance that in the next several years private property rights will become more secure, as will other civil rights. The 1999 amendment to article 11 in the PRC Constitution states that the private sector is important in the socialist market economy but does not give it equal protection.

The fact that the draft civil code would give private firms equal protection and redress in the courts is revolutionary. Moreover, there would be a property rights registration system. Once people have clear title to their property, they can get mortgages. A capital market will develop, and new wealth created. And people will be empowered.

The case for protecting private property rights is even found in the Chinese press. Recently, there was a very good article in the China Daily on the civil code, and it talked about establishing basic rules of a market economy. That is what needs to be done. The Chinese recognize this.

Better protection of private property rights will increase human rights. The draft civil code, if enacted, would afford greater security for personal privacy—protecting one's reputation and credit information, for example. And victims of rights violations would be compensated.

There is also a section on child labor. The draft code does not try to outlaw child labor, but abuses will be punished. Children under 16, for example, will not be able to work in certain jobs, but they will still be able to help support their families by working part-time.

A new civil code that affords equal protection and due process for private owners will clarify the "rules of the game" for the judiciary. There will be published laws that people can actually point to, which will make it easier to defend one's rights.

The first section of the draft civil code that is likely to come before the National People's Congress, perhaps as early as March, is the section on property rights. So, we should pay close attention to this.

Mr. RANDOLPH. I was attending a conference in Qinghua University in June on the law of property that is to be part of this code, and I provided you my translation of that. I did not translate those portions dealing with the household responsibility system, because, frankly, I do not understand that system. Perhaps a colleague could translate that system.

But, I have to warn you that this is a scholar's draft. And the politicians have not yet gotten a hold of it. And I cannot guarantee that what you see is what you will get. I may have much of what is likely to go into the civil code. Much of what is in the property section of civil code is already part of Chinese law. A good portion of the property code is extracted, almost verbatim, from what is called the Security Law.

And in addition, I believe that it is anticipated that the base contract law, almost verbatim, will go into the civil code. So, it is just kind of an elevation of maybe lower-level legislation into a more

permanent and perhaps a more significant legislation. But, it is not as if a lot of this is new.

Mr. COHEN. If I could add one thing to that. Past experience suggests that sometimes when these civil codes are drafted there is a sacrifice of interest in IPR to general principles. So, it may not all be to the good.

Mr. SCHWARZWALDER. Just to also add one thing with respect to the rural issue. We also commented within the property law that there is a specific section on rural land rights. And, again, there is very little in that section that will differ from what is incorporated into the Rural Land Contracting Law.

The property laws are the next level up, representing broader principles, and then filled in with subsidiary legislation, such as the Rural Land Contracting Law.

Mr. FOARDE. To have the last word, because our time is running out very quickly, let me recognize Keith Hand.

Mr. HAND. Jim, you mentioned during your presentation that property rights are not viewed as a natural right in China, but instead as a concession of the state. Obviously, this makes them subject to state interest and third-party interests on an ongoing basis. This will be a question to all of you on the panel.

I am wondering if you have seen any evidence that the Chinese Government, the academy, or even the public at large, are beginning to talk about property rights as a natural right? Or is that subject not even within the realm of discussion?

Mr. DORN. Well, that is a good question.

Actually, I had cited Liu Junning, an independent scholar in Beijing, who talks about the "constitutional order of freedom." He actually has a Web site that discusses the ideas of John Locke and James Madison, who argued that the power of government stems from the consent of the people, and the duty of government is to protect life, liberty, and property. These ideas are being discussed in China, but not without personal risk.

There is a journal, "Res Publica," published in China that has numerous articles on political philosophy from a classical-liberal perspective. So, market-liberal ideas are being discussed and, actually, one scholar who received his Ph.D. at Peking University—I won't mention his name—wrote his thesis on the idea of spontaneous order and F.A. Hayek, a recipient of the Medal of Freedom and author of "The Constitution of Liberty," which has been translated into Chinese. The Unirule Institute in Beijing, one of the first private think tanks in China, actually held a seminar to discuss Hayek's work, which was written about in the Wall Street Journal. So, Chinese scholars are being allowed to work in these areas, but there are risks.

Recently, I wrote an article about privatization for *Caijing*, a leading business magazine in China. I was pleased to learn that the editor had already published several other articles on privatization by leading Chinese scholars. So, she has the support of certain people within the government who are allowing her to do this. Other people would like to see her go out of business, but there is this split. We should not think the Communist Party is homogeneous; there are those who favor reform and those who oppose it.

Mr. FOARDE. Well, with that, my friends, I think we have far from exhausted the topic, but exhausted everyone here. And so I would thank our panelists, Jim Dorn, Mark Cohen, Pat Randolph, who has already gone off to catch his airplane, and Brian Schwarzwaldner for joining us and sharing these insights into these very important issues with us.

This concludes our issues roundtable for today. We hope to have another at the end of the month. So, please watch our Web site and sign up for our distribution list, if you want to get information about it. We should have more information available in a couple of days. Thank you all for coming. Good afternoon.

(Whereupon, at 4:33 p.m., the roundtable was concluded.)

A P P E N D I X

PREPARED STATEMENTS

PREPARED STATEMENT OF PATRICK A. RANDOLPH, JR.

FEBRUARY 3, 2002

I am an American academic and lawyer specializing in real estate law, including leasing, finance, development and title issues. I have served in the leadership of the American Bar Association Section on Real Property, Probate and Trust Law for many years and have published eight books and scores of articles on American real estate issues.

Ten years ago I was invited to teach Real Estate Law at Peking University, and thus began an interest in the development of Chinese real estate law that I observed in its beginning stage at that time. Since then, I have traveled to China frequently and have invited Chinese scholars to collaborate with me in America. I have co-authored a book and a number of articles on Chinese Real Estate Law and have lectured on real estate topics at most of the major Chinese law schools. I have established academic programs for Chinese students in America and for American students in China. Recently, I have participated in the Center on Chinese Land Law and Policy at Peking University, which will develop a central source of information in English and Chinese, regarding developments in Chinese Real Estate Law, and to provide a resource of American expertise on real estate matters for Chinese practitioners and policymakers. I will serve as co-Director of the Center.

My book, *Chinese Real Estate Law*, published by Kluwer International Law Publishers, is the only book length treatment of this topic in English written by someone with background in real estate law practice. I attempt to synthesize the various sources of Chinese law to suggest the way Chinese law would address problems of concern to persons involved in market real estate transactions.

I do not speak or read Chinese, and my expertise is based upon collaboration with Chinese lawyers and academics who speak English. Although this necessarily is a limitation on my development of any true expertise, I can say that at the elite Chinese law schools I have been able to interact with students and academics from every part of China, have obtained insights that one might not obtain from government or business organs.

1. OVERVIEW OF CHINESE REAL ESTATE SYSTEM

1.1. INTRODUCTION

Until 1988, there was one simple law of real estate in China—the government owns everything. Although the government divided its control of the land resources in China into different compartments and vested various governmental elements with responsibility and control, there were no individual rights in land and any arrangements that had been made could be unmade by government fiat.

In 1988, China amended its Constitution to provide for the recognition of privately owned transferable rights in land. Although the Chinese Constitution does not have the same force of law that the American Constitution does, this change was an important symbolic step, and presaged an array of changes in governmental statutes and regulations that implemented a system of private ownership and exchange of real estate. The developmental process was slowed by political unrest in China occurring also in 1988, and when I arrived in 1992, China was just beginning to act on the development opportunities offered by the legal changes.

Since 1992, there has been real estate activity in China's cities on a scale perhaps unequalled in human history. Certainly the legal system that has been developed since 1988 has been a critical element in accomplishing this real estate activity, but the physical development has surged far beyond the legal development.

China has some law in place, and there certainly is recognition and protection of ownership. Private bargains can be struck with some degree of assurance that the law will enforce them. Lenders have some clarity of right to reach security given for loans. But there is little certainty, on a nationwide basis, that the rights technically recognized in the Chinese laws will be fully recognized by those who administer the Chinese legal system, although there is steady improvement in this area.

Perhaps more important is the fact that the Chinese real estate system has yet to undergo the test that will come when the "first bubble bursts"—when China's real estate market experiences the inevitable economic correction that must come as part of the cycle of economic activity. It is only then that we will know how well the rights and expectations created by the system will stand up to the pressures

of political expediency. We have had the same “test of fire” of the legal system in this country a number of times during our history, and each time we have identified weakness that needed correction.

In short, the existence of a “rule of law” cannot be proclaimed. It must be experienced. It must be measured again and again as new pressures arise to test its stability. No social system is immune from such tests, and no legal system responds to these tests perfectly. Since the system of private rights was first established, China has yet to experience its first real test.

1.2. BASIC CHARACTERISTICS OF THE SYSTEM

The basic building block of the U.S. real estate economy is perpetual and relatively comprehensive ownership. The “fee simple absolute” is an ownership interest in land that can be transferred and inherited indefinitely into the future. It cannot be said to be “absolute ownership” because land rights in America are subject to rather extensive government regulation. But that which is not regulated or limited by the rights of other landowners is owned outright. This basic concept permits enormous flexibility in the American economic system. Those who hold such rights can divide and redivide these interests in thousands of ways, and our complex private economy attests to the inventiveness of American property owners to find the highest and best use of various aspects of land ownership.

By contrast, the basic element of ownership of Chinese land is far more limited. The “granted land use right” is given for an identified period—40 to 70 years depending upon the purpose for the grant. Although, theoretically, there are some renewal rights, the time for renewal of any such rights is still well in the future, and the terms of renewal remain uncertain. The right is given by government only for purposes of implementing a particular use, and permission must be obtained to change the use. It should be noted, however, that in most cases these use restrictions are no different than use restrictions typically imposed in America through zoning and land use laws. A more important limitation is that speculation in raw land is restricted through the requirement that the user commence the required use within 2 years. If the property is not developed, it cannot be transferred and in fact it may be forfeited back to the government.

In addition, it should be noted that the land use right in China does not carry with it the extended package of rights to subsurface and above surface activities that American ownership typically has included. The Chinese government continues to control all mineral resources and air rights. Over time, the U.S. has moved to a significant restriction of these rights in American property as well, however.

The granted land use right is similar in some ways to the long-term ground lease that is commonly used in America to develop commercial sites. The difference is that the Chinese right is obtained from, and reverts to, the government, rather than a private owner, and the consideration for the right is paid “up front,” and is forfeitable if the property is not developed.

Chinese granted land use rights are protected from expropriation without compensation.

China has a reasonably reliable system of registration of land use rights that permits identification of the owners. In an important recent development, China has established that there shall be unrestricted public access to these land records nationwide—an important development that western investors have been seeking for some time.

Since the land use right can be transferred, China has developed a system of rules governing the leasing, mortgaging and sale of these rights. The rights can also be inherited and there are rules concerning division of the rights upon divorce. Generally speaking, the various legal rules that have been developed reflect the Chinese predilection to favor control and guidance from government over individual freedom of choice. Leases cannot be for more than 20 years. Lenders are strictly controlled as to how much they can lend against the value of the land.

Although the relatively new Basic Law of Contract proclaims that the parties are free to contract as they please and that their bargains will be upheld, it remains to be seen whether bargains will be upheld that create interests that are inconsistent with the many regulations of the Bureau of Land Administration or the Ministry of Construction. For instance, one Chinese mortgage rule requires that all leases continue to exist following a foreclosure of the landlord's interest. In America, by contrast, there is extensive bargaining among lender, landlord and tenant with respect to the possible impact of foreclosure on the tenant's rights, and a wide variety of outcomes are possible. Another rule gives lessees a “right of first refusal” to renew at the end of the lease term or to buy if the landlord should sell the under-

lying ownership of the land. It is unclear whether this right can be “bought out” in advance, although clearly many Chinese transactions attempt to do this.

The Chinese legal system still does not recognize formally many concepts that apparently are being developed within the transaction system. There is no clear “easement in gross,” for instance, so it is unclear under what rights parties can extend pipelines or power lines. Although hundreds of millions of Chinese have moved into condominium residences in the last 5 years, there is no clearly developed condominium law spelling out their rights and responsibilities toward one another.

There is a proposal to include a section on property rights (“rights in rem”) in the new Chinese Civil Code that is expected to be considered for adoption this year. There have also been proposals made by high Chinese leaders to amend the Constitution to provide better protection for property interests, but the nature of these new changes remains uncertain.

1.3. OTHER PROPERTY RIGHTS AND EXPECTATIONS

1.3.1. *Homestead rights*

There are some rights to “homestead properties” that have been recognized as traditional interests virtually since the establishment of the People’s Republic. These properties exist both in urban and rural areas. The nature and basis of the rights has always been somewhat uncertain, as has been their number. Homestead rights, however, have never been viewed as granted land use rights, and it is unlikely that they have much protection against appropriation by government. Some people with homestead rights have been able to convert them to granted land use rights and now have a protectable interest. Others lack the sophistication or resources to carry out such conversions, and their interests remain vulnerable.

1.3.2. *Occupancy expectations*

After the Cultural Revolution, many people found themselves residing in or using properties as to which there were no clear rights of occupancy. Records had either been destroyed or never produced. As development has progressed, many of these occupants have been forced to relocate. The granting of land use rights on property that has been occupied in this way usually has required that the grantee pay for the relocation of those on the land, whether or not they had any formal right to be there. Twenty years ago, these persons were given quite a lot of informal protection through the negotiation of the granted land use rights.

In recent years, the sale of granted land use rights has become an important source of revenue for local and provincial governments, and there appears to be less solicitude for “undocumented” occupants of property that is part of a granted land use right. Although in theory the government can require the grantee to pay the cost of relocation, I have heard that the bargains over such relocation have led to less generous settlements.

1.3.3. *Household Responsibility System—Agricultural Land*

The system of granted land use rights has been used primarily in urban areas and for industrial and commercial development in the countryside. Agricultural property in the countryside has been under the control of agricultural collectives who have reallocated the property under their control to individual peasants under a system known as the “household responsibility system.” Peasants live and work on their allocated farm plots and have some autonomy in the management of their agricultural enterprises. We have heard stories recently of the wholesale breakdown of this system in the countryside as opportunities have arisen to consolidate land for purposes of corporate farming or industrial or commercial development. It appears that the individual peasants may in many cases be relinquishing their household responsibility ownership voluntarily for these purposes, but we have heard many reports that they do thereafter receive benefit from the reapplication of the property to other purposes that one would have expected them to enjoy as members of the Collective.

This problem may be a problem of failure to enforce legal rights and it may be a problem of simple fraud and sharp dealing by leaders in these countryside Collectives. Reports are, however, that the phenomenon is widespread in rural China.

A very recent new statute addressing some of these issues has been passed, and is discussed by another panelist. It remains to be seen whether the statute will be effective to slow down what appears to be a widespread movement.

2.0. PROBLEMS WITH ENFORCEMENT OF LEGAL RIGHTS

2.1. THE PROBLEM OF DIFFUSION OF LEGAL POWER

It is important to recognize that legal power in China is widely distributed. The popular U.S. image of the all-powerful monolithic central government is not an accurate picture of China in the area of economic rights. It is true that there is a tradition of overbearing government control in China, and consequently when central government and local government interests coincide, or at least do not conflict, it would appear that the Central Government has the power to effect strong controls over the population.

But in the area of division and management of economic resources such as land, there often are conflicts between the Central Government and provincial and local authorities. The Central Government lacks the political and social strength to prevail in many of these conflicts. Thus, even when the Central Government proposes a system of legal rights and expectations that may be sufficient to form a basis for a successful market system, it is up to the Provincial and local governments to provide effective enforcement mechanisms to insure that the system really works. In Guangzhou, Shanghai, Beijing, and other important commercial centers, there is recognition that a transparent legal system is vital to attracting investment capital and encouraging economic risk taking. Consequently, the legal system tends to follow the dictates of the Central Government rules, although extensive additional local control over real estate practices is commonplace. Often the local regulation in these areas, in fact, is benevolent, and assists in promoting effective market transactions by "filling in the gaps" of national rules.

This happy story of cooperation, however, is not repeated in many other areas. Local, County and Provincial governments control large sections of the taxing system and control the payrolls and other benefits that support courts and other agencies that are nominally organs of the Central Government. Consequently, when conflicts arise between local government interests and the interest of stability and predictability in the legal system, judges and administrators find themselves often under intolerable pressure. We have heard many tales of foreclosure proceedings delayed into exhaustion, of transfers of land use rights without regard to government-required plans and pursuant to special negotiations that might be viewed as inconsistent with concepts of fair opportunity.

If anything, the current frenzy of land development in China has increased the motive and opportunity for local leaders to ignore the rules in the name of expediency. Often this situation provides a breeding ground for corruption, and even more often individual property rights are frustrated by such activities. We saw similar abuses occurring during "boom time" periods in the development of our own country, and I suggest we should be neither surprised nor too dismayed that such things are now happening in China. Ultimately, as we have seen in the larger cities, a recognition is likely to develop that orderly process and clear rules will lead to greater economic prosperity. Egregious examples of corruption are periodically identified and dealt with, although cynics might argue that such activities are really ways of disposing of the most difficult political enemies rather than the most troublesome thieves.

2.2. ADDRESSING THE PROBLEMS

As I have suggested, to a certain extent, the problems observed in China are "boom time" problems that will disappear over time. But certainly an important factor in these problems is the lack of adequately trained lawyers and judges. Often departures from the national system of property management and destruction of property rights occur because no one in the local area really understands what the legal rules are.

Although there are a large number of Chinese judges, many of them lack formal law training and, unlike in America, even those with formal law training lack much experience in law practice. Further, there are few lawyers in many areas capable of insuring that their clients' interests are protected by law. The concept of the rule of law has only lately arrived in many Chinese provinces, and established lawyers have been successful by paying more attention to cultivating friends rather than advocating legal principles.

There is a need to educate lawyers in many areas of China as to the nationally mandated rules and procedures involved in the creation, transfer and protection of property rights. There is a similar need to provide such education for judges. Further, there is a need to encourage capable graduates of China's law schools (which have grown exponentially in recent years) to move into the outlying areas of China and to avoid the existing concentration in the major financial centers.

2.3. SPECIAL NEEDS IN THE HOUSING MARKET

In a recent meeting with leaders in China's housing industry, there was general agreement on the need for several social or legal developments to occur to facilitate the continued growth and prosperity of private property exchange in China:

- A national system of reliable credit analysis and review.
- Development of autonomous and responsible owners associations in Chinese housing complexes.
- Development of an industry for the resale of residential property (now most Chinese housing is still occupied by the original owner.)
- Development of real estate specialization among lawyers, who now are poorly prepared to address real estate problems in the residential marketplace.
- Resolution of the many conflicting provisions of Chinese real estate law and greater contractual autonomy in the commercial marketplace.
- Meaningful consumer protection in the housing development, finance, and resale markets.
- Clear rules regarding bankruptcy.
- As discussed above—adherence to national laws and enforcement of those laws by courts and administrators.

2.4. THE SPECIAL PROBLEM OF CORRUPTION

China needs to continue to be vigilant in the suppression of corruption. In my years in China, public concern about corruption has become the single greatest complaint from the Chinese citizens I meet. Ask any Beijing taxi driver!!

Land use rights are sold and regulated by local officials. As public land now passes into private hands, there are enormous opportunities for profiteering on two fronts. First, Chinese officials who generate revenues from the sale of the land have power to allocate those revenues. In many cases, these revenues may be used to finance joint venture investments by which individuals make great profits through the exploitation of these government funds. Although a 1998 law requires that proceeds from the sale of arable land be reinvested in the development of more arable land, there is widespread belief that this law is being ignored in favor of diversion of monies into other enterprises of more direct interest to the specific public officials who control the sale of land use rights.

A second means of corrupt practice in the creation of land use rights, of course, is in the identification and regulation of those who receive land use rights. In some areas, concerns about corrupt practices in the awarding of land use rights to favored persons at low prices reached such a pitch that sale by auction was required. But almost as soon as the auction requirement was enacted, exceptions to the rules crept in that preserved the options of local officials in "special cases."

In some cases, the creation of a "political machine" may have the short run benefit of insuring stability where law may not accomplish that result. For instance, there is little question that most housing development is being carried out by favored developers who have the inside track on obtaining land use rights for these purposes. But the fact that they are on the "A list" may lead these developers to be extra cautious to insure that they actually produce the housing that is called for and that no scandals result in terms of shoddy housing or sharp practices that may jeopardize their ability to continue in their favored position. Indeed, we hear remarkably few complaints about consumer housing considering the size of the market.

Inconsistent regulation of land use development also can be a problem. Since the power of forfeiture for failure to develop is so draconian, it is likely that there is some extortion going on where the possibility of forfeiture exists. The Chinese likely would be wise to consider less drastic interim measures to cope with problems of slow development in order to ease the friction at this point in the system.

A country that lacks a free press is particularly vulnerable to corruption. Perhaps China's greatest challenge in the economic arena is to secure the confidence of its population in the fairness and openness of its system of economic regulation, and China's concern that unrestricted freedom of the press endangers stability in other areas makes the achievement of such confidence far more difficult.

3.0. THE SIGNIFICANCE OF PROPERTY RIGHTS AND HUMAN RIGHTS

It should be noted at the outset that the recognition of property rights in China has occurred for economic reasons—to encourage individual responsibility for economic decisions that will fuel an effective marketplace and an adequate distribution of resources. China wants its population to have a better physical standard of living, and believes that market principles may achieve that result. In short, it can be said

that the Chinese value individual property because this is in the best interests of the collective.

Although these considerations also are present in our political system, the recognition of property rights in America is more fundamental, and reflects a social and philosophical balance that is not necessarily a part of Chinese political philosophy. We tend to view our citizens as deserving of individual liberty and autonomy, and the recognition of private property is an important part of that personal autonomy. Consequently we view individual property rights as a distinct objective, and may sacrifice the interests of the collective in some circumstances in order to protect such rights.

In evaluating the progress of individual property rights in China, we should maintain our focus on why China is promoting these rights, and not expect more from China than it is reasonable to expect.

On the other hand, I believe that the development a greater degree of individual autonomy that inevitably results from the protection of property rights will lead, ultimately, to stronger individual rights in other areas of Chinese life as well. Those who have something to protect and preserve often seek a greater voice in government. Chinese government is not closed to the voices of the people. It is not as responsive to those voices as might be the case in a democracy, but neither is the Chinese government a despotic and uncaring parasite. But at present many Chinese citizens are "apolitical." As citizens in China increasingly become aware that governmental policies will have a direct result on their opportunity to keep what they have and obtain what they want, they will demand a greater voice in government, and will demand that government respect their autonomy.

A significant problem in this development, of course, is the fact that the Chinese government's second great goal, concurrent with economic development, is political stability. The development of greater citizen participation in government threatens those with entrenched power, and it is only a short step from perception of a challenge to ones power to the conclusion that government stability is in danger. But the development of individual property interests is so much a part of the economic system at present that it does seem unlikely that Chinese officials will take significant steps to frustrate such expectations. Accommodation of political change, therefore, is possible and it is likely that the change will be in favor of greater levels of individual autonomy.

Other institutions in the society that serve to promote the market economy—such as the development of trained lawyers and other social advocates, private trade associations such as brokers groups and owners groups, and the free exchange of information that necessarily flows through a market economy, will lead to social expectation of greater power and gradual reform.

Consequently, U.S. policy in the area of Chinese real estate ought to be to recognize that a healthy system of exchange of private real estate interests is likely to lead ultimately to demand for and realization of a greater individual autonomy and citizen voice in government in China, both goals that are critical to the greater development of human rights.

PREPARED STATEMENT OF BRIAN SCHWARZWALDER

FEBRUARY 3, 2003

Although it has attracted scarce attention from American media, policymakers, and academics, in recent years China has undertaken a series of policy and legal reforms designed to fundamentally transform the nature of the agricultural land rights held by rural households. Because agriculture remains a primary source of income for most rural households, and land represents their most important asset, the success or failure of these reforms will have dramatic implications for the economic, social and political future of the more than 800 million people that reside in rural China.

A BRIEF OVERVIEW OF RURAL LAND RIGHTS IN MODERN CHINA

The question of who possesses which rights to rural land has been a central issue in China's development over the past 50 plus years. Peasant support for the Communists and against wealthy landlords was an important factor in Mao's victory over the Nationalists in 1949. An early attempt at land reform, in which previous tenant farmers were given full private ownership, was swept aside by large-scale collectivization beginning in the early 1950s. The 30 million deaths resulting from the Great Leap Forward famines of the late 1950s proved that, without access to their own plot of land and the right to reap the profits from its cultivation, Chinese

farmers lacked the incentives necessary to produce enough to feed the country's vast population on its modest arable land base—China has over 20 percent of the world's population but less than 9 percent of the world's arable land.

Perhaps because of these challenges, China was the first Communist State to break up its collective farms. A decollectivization program known as the Household Responsibility System [HRS], which was implemented throughout China in the late 1970s and early 1980s, clearly demonstrated that giving farmers individualized family holdings resulted in increased productivity, higher incomes, better diets, and a narrowing of the gap between urban and rural incomes. Under the HRS, ownership of the land remained with the village or township, while farm households were granted rights to cultivate the land and retain any production above and beyond a contracted quota. Such "collective ownership," with use rights allocated to households, remains the dominant form of land tenure throughout rural China.

My organization, the Rural Development Institute of Seattle, Washington [RDI], has conducted detailed field research on rural land tenure issues in China since 1987. In the past 15 years, RDI researchers, all of whom are attorneys, have directly interviewed over 800 farmers in more than 20 Chinese provinces. RDI has also cooperated with Chinese researchers in the design and analysis of two large-scale, random-sample surveys of farm households concerning their land rights. The goal of RDI's research has been to provide the Chinese leadership with detailed, accurate information and recommendations for legal and policy reforms in the system of agricultural land rights.

RDI's initial research in China confirmed that the HRS reforms, by giving farmers individualized parcels from which they would reap the benefits, allowed them to undertake a series of short-term farming improvements—things like more effective weeding than had occurred on the collectives, more attentive application of fertilizer, and more concerted planning with respect to the timing of planting and harvesting. But farmers' use rights, while individual, suffered greatly from the fact that village officials could frequently and unpredictably "readjust" those rights into entirely new patterns, taking away and granting land parcels on the basis of changes in household size. Because of these readjustments, farmers could never be certain of their tenure on any individual piece of land. They were therefore unwilling to make productivity-enhancing investments that required several years to recover, such as irrigation, drainage, or land terracing.

THE NEW RURAL LAND CONTRACTING LAW: STRENGTHENING FARMERS' RIGHTS TO LAND

A series of recent legal and policy reforms has taken positive steps toward providing farmers with the long-term land tenure security they have previously lacked. The most significant of these reforms is the adoption of the Rural Land Contracting Law [RLCL] on August 29, 2002. This new law represents a breakthrough in three major areas:

Basic land tenure security

Although the RLCL stops short of providing rural households with full private ownership of their land, the rights it creates embody many of the characteristics of private property rights. The new law reaffirms in a very detailed way and in formal law what began as a broad policy pronouncement in 1993, that farmers are entitled to 30-year (one generation) land rights. Thirty-year rights are long enough to recover the value of nearly every kind of agricultural investment, and, depending on the discount factor employed, such 30-year rights represent somewhere between 75 percent–95 percent of the economic value of full private ownership. The law further requires that rights to rural land must be backed by written contracts and use right certificates that contain certain core provisions reflecting national laws and policies.

Most importantly, under RLCL Article 27, land readjustments are permitted only in extreme cases, such as when contracted land has been seriously damaged as the result of a natural disaster. Moreover, before a land readjustment can be conducted under Article 27, a series of procedural requirements designed to further limit the impact of readjustments rights must be satisfied. Research conducted by RDI and others, including the World Bank, has shown that the majority of farmers would welcome an end to land readjustments, and that farmers in the small minority of Chinese villages that have never employed land readjustments are strongly in favor of a no-readjustment rule.

For the first time in any law or policy related to rural land rights, the RLCL specifically addresses the issue of women's rights to land. Because rural Chinese women typically leave their parents' village upon marriage to establish residence in their husband's village, they will be particularly vulnerable to losing land under a no-readjustment rule. Previously, women could expect to receive an allocation of land in their husband's village in the first readjustment following their arrival. By

contrast, under the new rule, women will not be entitled to receive land in their husband's village through the process of land readjustment. They may, however, be able to obtain land in their husband's village in the form of wasteland (uncultivated land) or flexible land (a small proportion of land reserved by the village to compensate for additional population), if such land resources are available. The RLCL's solution to this problem is to provide, in Article 30, that a woman receives a share of land in her husband's village, she retains the right to a proportionate share of her parents' land under the concept of joint share property.

The legal framework for transactions involving rural land use rights

In many of China's cities, burgeoning markets for 50 and 70-year use rights to commercial and residential land have already developed. In places like Beijing, Shanghai, Shenzhen, and Guangdong, these rights are also highly valuable. However, the same cannot be true for use rights to rural land.

RLCL Articles 32–43 provide the most comprehensive set of rules to date governing transactions in rural land use rights, creating a legal framework for the development of markets for such rights. Transfers of rural land use rights were theoretically permitted under prior law, but the insecure nature of the rights meant that few farmers were willing to pay to acquire them for more than one season or 1 year at a time. The RLCL explicitly authorizes “transfer, lease, exchange, and assignment” of rural land use rights (Article 32). Right holders transferring less than the full remaining use term are not required to obtain the approval of the collective landowner; however, such approval is required for assignments of the full remaining term. A written contract must be entered into for any transaction of longer than 1 year, and basic requirements for the content of such transaction contracts is set forth by the law. In all transactions, members of the collective economic entity in which the land is located possess a priority right, though the law is unclear as to how this right will be exercised.

Functioning markets for long-term rural land use rights will accomplish two important goals. They will allow voluntary, gradual re-allocation of land rights to the most efficient farm households. They will further allow farmers to realize the value of “dead capital” (to use Hernando de Soto's phrase) currently tied up in the land. Markets for agricultural land in comparable Asian settings suggest that the 135 million hectares of rural land in China should eventually attain a total value of \$500 to \$600 billion US dollars—an average of between \$3,500–4,500 per hectare. The combination of higher productivity and new wealth in the hands of farmers holds the potential to significantly accelerate rural economic development, which has lagged in recent years.

Strengthening the rule of law in China's countryside

The RLCL holds the potential to accomplish this through a series of very clear and strong rules prohibiting violations of farmers' land use rights by local officials. It also imposes strict civil penalties on any such violations, including monetary damages and restitution, and equitable remedies to forestall or reverse the illegal action. In the past, farmers had no legal recourse when such violations occurred. It is also important that the new law allows farmers to choose between a variety of dispute resolution options, including consultation, mediation, arbitration by a specialized land contract arbitration body, or directly filing suit in the People's Court.

IMPLEMENTING THE NEW LAW: CHALLENGES AND PROSPECTS

As with any major legislative reform in China, adoption of a new law is merely the first step in the process. Implementation of the Rural Land Contracting Law in hundreds of thousands of rural villages represents a formidable challenge. However, very recent statements by new President Hu Jintao, Premier-to-be Wen Jiabao, and NPC Chairman Li Peng appear to indicate an increased emphasis on rural and agricultural issues generally, and a commitment to effective implementation of the Rural Land Contracting Law in particular.¹ These strong expressions of support by the central government will be an important factor in achieving implementation of the RLCL, but significant obstacles to implementation persist at local levels. Many

¹ Both Hu Jintao and Wen Jiabao delivered speeches at the Central Rural Work Conference, held in Beijing on January 7–8, 2003, in which they emphasized the importance of increasing farmer incomes, expanding demand and consumption by farmers, and coordinating urban and rural development. Four priority areas for rural work were identified at the conference, the first of which was the need to “respect the status of farmer households as the main players on the market; implement the land policy and the Rural Land Contracting Law; and give farmers long-term and guaranteed rights to use land.” See “Chinese Leaders Address Central Rural Work Conference,” (Jan. 9, 2003), Xinhua News Agency, available in LEXIS-NEXIS online data base, BBC Worldwide Monitoring Library.

township and village cadres will be reluctant to loosen their grip on land by providing farmers the new rights created by the law. In some areas, farmers will be reluctant to embrace changes to the rural land system. The experience with implementation of previous rural land policies and laws, both successful and unsuccessful, indicates that the following eight steps can and should be taken in order to increase the prospects of timely and effective implementation of the Rural Land Contracting Law:

1. Formulate and issue implementing regulations

Implementing regulations will be necessary to further interpret several provisions of the RLCL. The most important step will be to unambiguously and narrowly define the “other special circumstances” under which land readjustments can be conducted (Article 27). Clarification of provisions governing inheritance, priority rights to transfer for collective members, and women’s rights, will also be necessary. RLCL Article 64 states that “[T]he Standing Committee of the People’s Congress of each province, autonomous region and province-level municipality may promulgate implementing regulations in accordance with this law and the practical situation in its administrative jurisdiction.” Legislative departments at the province level should act quickly to promulgate such rules.

2. Conduct a comprehensive publicity campaign

It is vital that the law’s adoption be followed by a detailed, repetitive publicity campaign targeted at educating both local officials and farmers regarding the new rules. A variety of media should be used, but the two 17-province surveys on the implementation of 30-year land use rights under the LML indicate that television is the most effective medium for communicating to farmers. The subjects covered by the publicity campaign should include rules concerning land readjustments, the newly detailed rights to conduct transaction, the existence of the law’s vital provisions on dispute resolution and methods for employing them, and the nature of women’s rights.

3. Monitor implementation

A comprehensive program should be established to monitor implementation of the new rules, including both direct field interviews with farm households (using Rapid Rural Appraisal methods) and an updated random sample questionnaire survey to be conducted using methodology that provides a highly detailed and accurate picture of implementation nationwide. The results should be quickly conveyed to policymakers at both the provincial and national levels, to provide them with information concerning the extent and nature of implementation of the new law, and to help them in developing targeted solutions to problems relating to implementation that are discovered as a result of monitoring efforts.

4. Establish telephone hotlines to receive and process farmer complaints

Closely related to the monitoring function, the central government should establish a system for receiving and processing farmers complaints related to illegal land readjustments and other violations of farmers’ land-use rights. The establishment of telephone hotlines at the province level would be a simple, low-cost, yet effective way to meet this objective. Such hotlines have been widely employed in urban areas of China, and effective models could easily be adapted for use in the countryside.

5. Improve dispute resolution mechanisms

The RLCL provides an extensive set of tools to ensure that farmers in fact will enjoy long-term and secure land-use rights, and that the rule of law with respect to rural land issues will be effectively implemented in the countryside. Initially, the content of these provisions should be widely publicized to farmers. Then, as experience is gathered in the early months of actual implementation, TV programs may be used to publicize the most common kinds of violations found, and actual cases where the law’s provisions concerning penalties and remedies have been enforced. The establishment of new dispute resolution mechanisms, such as the specialized land contract arbitration body envisioned in RLCL Article 51, and the improvement of existing judicial and administrative dispute resolution mechanisms can only be viewed as a long-term objective, but will be crucial to the success of these reforms and the development of the rule of law in rural China.

6. Provide legal aid services to farmers

At least pilot projects should be developed to provide legal-aid services to farmers in order to protect and vindicate their land-use rights under the RLCL. The functions of legal-aid personnel should include representing farmers before the Peoples’ Court or before an arbitration body, as well as in consultation or mediation efforts

that may precede litigation or arbitration where the farmer so desires (see Article 51). Legal-aid personnel can also serve as a source of publicity and information as to farmers' rights which may be more detailed than that provided through TV or other general media.

7. Improve registration of land-use rights and transfers

Another subject on which at least pilot projects should probably be undertaken is the registration of land-use right certificates and of the transfers of such land use rights for periods of 1 year or more. Currently, land use right contracts issued to farm households are only registered at the time of their issuance (if at all), with no subsequent updating of records upon transfer, death of household members, land readjustment, or other changes. Both significant financial outlays and extensive training of personnel will be required to meet the long-term goal of developing an effective rural land right registration system. Initial pilot projects related to registration should be focused in locations where there has been strong implementation of farmers' land-use rights, and the preconditions for reliable longer-term transfers of such use rights from one farm household to another farm household have therefore been established.

8. Train local officials

Many of the measures and activities described above involve the need to train personnel and local officials with respect to the provisions of the RLCL and their implementation. Such training will be needed for "front line" officials engaged in implementation both in the collective entity and at levels above the collective, and for specialized officials who may play a particular role in implementation, including hotline operators, Peoples' Court judges, arbitrators, legal-aid providers, and registration officials.

IMPLICATIONS FOR U.S. POLICY

Land reforms that provided secure, individual tenure rights for small family farmers were part of the U.S. policy agenda in post-war Asia. In Japan, Taiwan, and South Korea, these land reforms played a crucial role in achieving grass-roots development and the stabilization or evolution of democratic institutions. They were also a vital part of the economic transformations that made these three societies strong and reliable economic and political partners of the United States.

The adoption of the Rural Land Contracting Law presents a new opportunity for U.S. policy to engage with China to promote the importance of the respect for private property and the rule of law in China's development process. Among other initiatives, the U.S. Government should provide continuing and increased support for rule of law programs in China that may not necessarily be directly linked to rural land reforms, but will help to ensure their long-term success. These programs include exchanges between U.S. and Chinese legislators and legal scholars, training for Chinese judicial and administrative personnel, and funding for the establishment of legal aid services in China.

PREPARED STATEMENT OF JAMES A. DORN

FEBRUARY 3, 2003

Good afternoon. Thank you for the opportunity to address the issue of property rights in China, especially the pace of enterprise privatization, capital-market liberalization, and the implications of ownership reform for human rights and civil society.

The primary goal of the fourth generation of leaders in China is to maintain strong economic growth and increase prosperity throughout China. To do so, they will have to confront a number of serious problems, particularly the debt-ridden financial system and the inefficiency of state-owned enterprises (SOEs). China's big four state-owned banks are technically insolvent, with nonperforming loans (NPLs) estimated to range from 25 to 40 percent or more of outstanding loans. SOEs account for more than two-thirds of all bank loans but produce less than one-third of the total value of industrial output. That massive waste of capital under China's socialist market economy cannot be stopped without fundamental reform—in particular, privatization and the rule of law.

Pumping more funds into state-owned banks to keep them afloat will only postpone the day of reckoning and increase the overall cost of reform. Likewise, turning SOEs into shareholding enterprises, with government as the major owner and with most shares being nontradeable, will not transform those firms into profitable entities. History has taught us that without private ownership and the threat of bank-

ruptcy, there is little incentive to reallocate capital to its most highly valued uses. Until State banks and enterprises are fully privatized and effective limits are placed on the power of government, waste and corruption will continue.

China's largest SOEs remain under firm control of the government, but many medium- and small-sized SOEs have been restructured. Moreover, since 1978, Beijing has allowed experimentation with different forms of ownership, and there are now more than 20 types of ownership, including private firms, collective firms (e.g., township and village enterprises, many of which are private), joint stock companies, and foreign-funded enterprises. The exact scope of the private sector is difficult to calculate because private firms often "wear a red hat" and conceal their true identity in order to gain access to State bank loans at subsidized interest rates and other government favors. A reasonable estimate is that the private sector now accounts for about 33 percent of GDP.

The great success of private and cooperative enterprises over the past 25 years—they now account for more than two-thirds of the value of industrial output—has resulted in official recognition of the importance of the nonstate sector as an engine of economic growth. Article 11 of the Chinese Constitution, amended in 1999, now reads: "Individual, private and other non-public economies that exist within the limits prescribed by law are major components of the socialist market economy."

Private firms were illegal in 1978, and SOEs dominated the economic landscape. Today there are nearly 2 million private enterprises employing more than 24 million workers, and the number of private enterprises is growing by more than 30 percent per year. In Shanghai and other coastal cities, SOEs are becoming small islands in a sea of private enterprise. Much of the growth of the private sector has been spontaneous, in the sense that privatization took place without central direction as opportunities for trade increased, especially in the special economic zones (SEZs). Local jurisdictions were allowed to experiment with new ownership forms, and, when they were successful, others sought to imitate that success. Only later did the central authorities put their stamp of approval on the institutional innovations.

The growth of private enterprise has occurred despite the lack of transparent legal title and restrictions on access to State bank credit. Informal private capital markets have evolved to fund the private sector, and overseas Chinese have been an important source of investment funds. The strong performance of provinces with greater economic freedom, such as Fujian, Guangdong, and Zhejiang, has created a new middle class and a demand for better government and more secure property rights.

Capitalists are now free to join the Chinese Communist Party, and several well-known private entrepreneurs are already members of the National People's Congress. As more entrepreneurs join the party, there will be mounting pressure to change the status quo. At the 16th National Congress of the CCP in November 2002, President Jiang Zemin gave a clear signal that the private sector is an important part of China's future. He said, "We need to respect and protect all work that is good for the people and society and improve the legal system for protecting private property." The party charter now includes "The Three Represents"—a doctrine that commits the party to embrace "the fundamental interests of the majority of the people," not just the proletariat.

Chinese citizens can now own their own businesses, buy shares of stock, travel widely, hold long-term land use rights, own their homes, and work for nonstate firms. The depoliticization of economic life is far from complete, but the changes thus far have created new mindsets and expanded individual choice. The many restrictions and human rights violations that remain should not detract from the progress China has made since 1978 in raising the standard of living for millions of people and giving rebirth to civil society.

China's accession to the World Trade Organization, in December 2001, has resulted in a long-term commitment to economic liberalization and legal reform. The policy of engagement is working to change China's legal system and to better protect property rights and, hence, human rights. At the 16th party congress, Jiang called for improving markets (including "the capital market" and "markets for property rights"), abolishing "trade monopolies and regional blockades," and deregulating interest rates. The outgoing leader of the world's largest communist party told the new leaders, "We must give full scope to the important role of the non-public sector."

That rhetoric should be taken seriously. The nonstate sector is providing a safety net for unemployed workers from SOEs. As restructuring takes place, China will need a rapidly growing private sector to maintain strong economic growth. Strengthening the private market sector will require a clear commitment by the national government to giving equal protection to private property rights and to liberalizing capital markets so that entrepreneurs have access to domestic capital that is now

locked up in inefficient SOEs. Real reform, however, will require more than “revitalizing” SOEs and “recapitalizing” state-owned banks; it will require a firm commitment to widespread privatization of state-owned assets. Until the government and party are shut out of banks and enterprises by privatization, corruption will continue and NPLs will mount. What China needs is real, not pseudo, capital markets with freely tradeable shares, liquidity, and trust.

Markets work best when property is fully protected by the rule of law and people are free to choose. We should not forget the words of James Madison, the chief architect of the U.S. Constitution: “The personal right to acquire property, which is a natural right, gives to property, when acquired, a right to protection as a social right.” China is beginning to recognize the right to private property, but only as a right bestowed by the State not as a natural (inalienable) right. Consequently, private property can never be secure until there is a fundamental revolution in political philosophy that places the individual, not the state, at the center of the moral universe and limits the power of government.

Recent changes, however, are encouraging:

- Qualified foreign institutional investors will be allowed to buy equity stakes in SOEs through the A-share (local currency) stock exchanges in Shanghai and Shenzhen;
- Strategic foreign investors will be allowed for the first time to buy the nontradeable shares of listed and unlisted SOEs;
- Foreign joint-venture investment funds will begin operation;
- Private commercial banks are being established in rural areas;
- China’s first civil code has been drafted, including an entire chapter dedicated to the protection of private property rights;
- China’s top judge, Xiao Yang, president of the Supreme People’s Court, has called for safeguarding private property rights and told a national conference in Beijing: “Efforts should be made to enhance awareness of the need for equal protection of all subjects in the marketplace.”
- Farmers will have more secure land-use rights as a result of the Rural Land Contracting Law adopted in August 2002;
- Shenzhen, the first SEZ in China, is embarking on a bold political experiment, with Beijing’s approval, to limit the power of the local cadres, introduce checks and balances, and cultivate the rule of law.
- A new think tank devoted to studying political reform is planned for the Central Party School in Beijing;
- Numerous rules and regulations not in conformity with WTO norms are being scrapped and there are plans to streamline the central government’s complex bureaucracy.

All those reforms are being driven by the need to be competitive in an increasingly global economy. To attract and retain capital in the future, China will have to continue to improve its institutional infrastructure.

As China liberalizes its financial sector, removes remaining barriers to trade, and improves its legal structure, the range of choice for millions of Chinese will increase. That increase in economic freedom is sure to have a positive effect on creating what Liu Junning, an independent scholar in Beijing, has called “a constitutional order of freedom in China.”

The United States can help transform China by continuing the policy of engagement, ensuring that China honors its WTO commitments as well as its bilateral trade agreement with the United States, and adopting a more liberal visa policy that permits Chinese students and scholars—especially those in law, economics, and the humanities—to learn about and experience firsthand a free society.

RECOMMENDED READINGS

Business Weekly (2002) “State-Owned Firms Open Up.” November 19–25: 3. (Published by China Daily.)

Carpenter, T. G., and Dorn, J. A. (2003) “Relations with China.” In *Cato Handbook for Congress: 108th Congress*, 577–85. Washington: Cato Institute.

Dorn, J. A. (2002) “Liberalizing China’s Financial Sector.” Commentary, ChinaOnline (www.chinaonline.com/commentary—analysis/C02120636.asp).

—(2002) “The Need to Engage China.” *Asian Wall Street Journal*, 9 October: A11.

—(2003) “The Primacy of Property in a Liberal Constitutional Order: Lessons for China.” *The Independent Review* 7(4) (Spring): 485–501 (forthcoming).

Jefferson, G. H., and Rawski, T. G. (1995) “How Industrial Reform Worked in China: The Role of Innovation, Competition, and Property Rights.” In *Proceeding of the World Bank Annual Conference on Development Economics*, 129–70. Washington: World Bank.

- Jiang, Z. (2002) "Full Text of Jiang Zemin's Report at the 16th Party Congress." 16th National Congress of the Communist Party of China, 2002 (www.china.org.cn/english/features/49007.htm).
- Kynge, J. (2003) "Bank Reform May Give China's Farmers Their Place in the Sun." *Financial Times*, 10 January.
- (2003) "Chinese Politics." *Financial Times*, 13 January: 9.
- McGuckin, R. H., and Dougherty, S. M. (2002) "Restructuring Chinese Enterprises: The Effects of federalism and Privatization Initiatives on Business Performance." Research Report R-1311-02-RR. New York: The Conference Board.
- Meng, Y., and Shao, Z. (2002) "Private Property Owners Win with Reform." *China Daily*, 24 December: 3.
- Oi, J. C., and Walder, A. G., eds. (1999) *Property Rights and Economic Reform in China*. Stanford, Calif.: Stanford University Press.
- People's Daily (2002) "Chinese Private Economy Seeking Wider Development Space." 7 April.
- Pilon, R. (1998) "A Constitution of Liberty for China." In J. A. Dorn (ed.) *China in the New Millennium: Market Reforms and Social Development*, 333–53. Washington: Cato Institute.
- Restall, H. (2002) "After the Party." *Wall Street Journal*, 19 November: A24.
- Shao, Z. (2002) "Justice for All: State and Private." *China Daily*, 23 December: 1.
- Slater, D. (2002) "Opening the Gate." *FinanceAsia* (November): 34–37.
- Tsai, K. S. (2002) *Back-Alley Banking: Private Entrepreneurs in China*. Ithaca, N.Y.: Cornell University Press.

PREPARED STATEMENT OF MARK ALLEN COHEN

Thank you for inviting me here today to address the issue of intellectual property protection in China, particularly its status as a form of "property right."

Recognizing the Commission's role in monitoring compliance with human rights and rule of law in its implementing legislation, as well as its continued interest in WTO matters, the focus of my brief presentation will be on three topics: (a) the current State of protection of U.S. intellectual property rights (IPR) in China; (b) intellectual property (IP) and the rule of law in China; and (c) U.S. Government efforts to promote IP protection and rule of law in China.

I would like to say at the outset, that the comments I am providing today represent my own opinion on these important issues. They should not be considered as an official statement of U.S. Government policy. Some of the issues, such as the relationship between intellectual property rights in China and human rights or rule of law, are matters of long standing personal interest to me.

I. PROTECTION OF U.S. INTELLECTUAL PROPERTY RIGHTS IN CHINA

The Office of the U.S. Trade Representative (USTR) noted in its December 11, 2002 Report to Congress on China's WTO Compliance (the Report), that apart from certain systemic issues, IP was one of three issues that "generated significant problems and warranted continuing scrutiny". The Report further stated:

China did make significant improvements to its framework of laws and regulations. However, the lack of effective IPR enforcement remained a major challenge. If significant improvements are to be achieved on this front, China will have to devote considerable resources and political will to this problem, and there will continue to be a need for sustained efforts from the United States and other WTO members.

A key challenge for IP in China remains enforcement. USTR also noted:

Although China has revised its IPR laws and regulations to strengthen administrative enforcement, civil remedies and criminal penalties, IPR violations are still rampant. IPR enforcement is hampered by lack of coordination among Chinese government ministries and agencies, local protectionism and corruption, high thresholds for criminal prosecution, lack of training and weak punishments. As explained by one trade association, "[e]ffective enforcement against [IPR] infringement in China is universally recognized as the chief concern of [IPR] rights-holders, as piracy rates in China in all areas, including copyright, trademark and patents, continues to be excessively high."

One may legitimately wonder if this isn't "déjà vu all over again." This year in fact marks the 100th anniversary of the first bilateral agreement regarding protection for intellectual property rights, the "Treaty for Extension of the Commercial Relations Between China and the United States", (reprinted in *Treaties and Agree-*

ments With and Concerning China 1894–1919 (J.V.A. MacMurray ed., 1921)). This treaty granted copyright, patent, and trademark protection to Americans in return for reciprocal protection to the Chinese. Despite the 1903 treaty, China did not introduce a substantive copyright law until 1910, a substantive patent law until 1912, and a substantive trademark law until 1923. Moreover, although these laws appeared on paper, they offered foreigners very limited intellectual property protection, and IPR issues continued to persist into the end of the Qing Dynasty, into the Republican period, in later dealings with Taiwan, and later in our recognition of the PRC.

During the past few years, we have seen a quickening of the pace in China toward conformity of its IPR system with international standards. Since WTO accession, China has ambitiously promulgated, revised or annulled a large corpus of legislation, regulations, rules, etc. Yet despite these legislative efforts, U.S. industry is currently facing daunting challenges in China's market to combat these illegal operations.

U.S. copyright industries report that they face piracy rates of over 90 percent in the Chinese market. They are suffering losses of approximately four million USD per day due to piracy. The International Intellectual Property Alliance details some of these piracy rates for 2001 in its Section 301 submission to USTR as 88 percent in motion pictures; 90 percent in sound recordings/musical compositions, 93 percent in computer software, and 92 percent in entertainment software, for total losses of \$1,506.6 million.

Economic analysis can be easily supported by sight observations. Counterfeit and pirated goods continue to be omnipresent in China. They are sold at the Xiushui Market, near the U.S. embassy, in the Luowu market in Shenzhen, and other prominent venues, frequently in view of local authorities. Some industry officials estimate that 15–20 percent of the products sold under their labels are counterfeit. For certain products, it may be difficult in local markets to purchase legitimate goods. Pirated music, movies, motion pictures, video games and books have displaced legitimate sales, frequently before the legitimate product can achieve legal entry into the Chinese market. Pictured below is such a street near the Xiushui market, where a street dealer in DVDs and CDs may frequently be seen.



China's role as a manufacturer and consumer of pirated and counterfeit goods not only poisons the Chinese market for U.S. products. It affects our own market and third country markets. This was most evident in the mid-1990s, when China's exports of CD-ROMs of music and software were displacing U.S. exports, especially in Asia. After extensive bilateral discussions and agreements on intellectual property rights, China reduced its exports of pirate CD-ROMs.

For 4 out of the past 5 years, mainland China (not including Taiwan or Hong Kong) has been the top exporter of pirated and counterfeit goods to the United States, as measured by U.S. Customs statistics. The following are Fiscal Year 2002 seizure statistics from U.S. Customs:

Trading Partner	Domestic Value (USD)	Percent of Total
China	48,622,997	49.
Taiwan	26,507,356	27.
Hong Kong	3,959,258	4.
Pakistan	2,362,130	2.
Korea	1,825,265	2.
Indonesia	1,361,101	1.
Switzerland	1,274,645	1.
France	836,111	Less than 1.
Malaysia	721,979	Less than 1.
Kazakhstan	671,900	Less than 1.
All other countries	10,847,599	11.
Total FY02 Domestic Value	98,990,341	
Number of Seizures	5,793	

According to 2002 data, China accounted for 26 percent of U.S. Customs seizures and 49 percent of the value. Compared to fiscal year 2001, the domestic value of goods coming from China increased by 83 percent and the number of seizures increased by 84 percent. In only 1 year of the past five, China slipped to the number 2 position in U.S. seizures.

U.S. statistics however do not document the full extent of harm caused by Chinese exports. Counterfeit goods in particular are exported throughout the world, depriving U.S. exporters of their legitimate markets. Chinese counterfeits and pirates are also a leading source of seizures in the European Union, Japan and many other countries. Industry reports that Chinese exporters have produced counterfeit aircraft parts, counterfeit car parts, and indeed whole counterfeit cars and motorcycles. Occasionally Chinese products may also be repackaged and sold by illegitimate distributors. Many of these cases are multinational in nature and can implicate U.S. companies or individuals. For example, in one major case prosecuted by the U.S. Department of Justice, the U.S. distributors of Long March Pharmaceuticals (Shanghai) had repackaged a bulk pharmaceutical product, gentamicin sulfate, not approved for the U.S. market for distribution in the United States. In April 1997, the distributor was fined a total of \$925,000, and its owner was sentenced to 2 years in prison and fined a total of \$75,000 for illegally importing counterfeit pharmaceuticals from China and laundering money in a kickback scheme. According to testimony before the House Commerce Committee, six patients in Denver alone suffered toxic reactions. See, e.g., statement of Patricia L. Maher, Deputy Assistant Attorney General, Civil Division, U.S. Department of Justice Before the Subcommittee on Oversight and Investigations of the Committee on Commerce, U.S. House of Representatives, at <http://usinfo.state.gov/regional/ea/iprcn/20001003.htm>; see also <http://www.usdoj.gov/opa/pr/1997/April97/146civ.htm>; <http://energycommerce.house.gov/107/hearings/06072001Hearing267/print.htm> (Hearing Before the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, House of Representatives One Hundred Seventh Congress, First Session, June 7, 2001, Serial No. 107-30).

The challenges are indeed enormous. As IP crime extends beyond national borders, the cooperation of Chinese colleagues in law enforcement and in IP protection is critical. Not only are the commercial losses unsustainable in an era of WTO accession and mounting trade imbalances, but IPR crimes also feed organized crime and can support terrorist elements. As recently documented by Jeffrey Goldberg in "Party of God" in the New Yorker (October 28, 2002), in some countries, such as Paraguay, Chinese counterfeit goods appear to be marketed through Hezbollah and other groups. See also Roslyn A. Mazer, "From T-Shirts to Terrorism—That Fake Nike Swoosh May Be Helping to Fund Bin Laden's Network" Washington Post, September 30, 2001, at page B2.

What does the future hold? History shows us that China has a long tradition of being a major innovator of new technologies, such as gunpowder, the compass, irrigation techniques, and movable type. Chinese inventiveness was well documented by former British Consul in Chongqing, Prof. Joseph Needham, in his monumental

Science and Civilization in China. Looking to the future, China has indeed committed significant resources to revamping its laws, establishing a specialized IP court system, implementing specialized administrative agencies with power to fine infringers, and enacting and publicizing laws or measures that may extend beyond TRIPS minima.



Beijing Administration for Industry and Commerce Sign: "Model Market for No Counterfeit Trademarks, 2001"

There are many signs that intellectual property is becoming more important to China. In 2002, for example, China became the leading country in the world for receiving new trademark applications. In 2001, there were nearly 10 times as many Chinese applications for trademarks in China compared to foreign (229,775/23,234). Markets for legitimate applications of intellectual property are beginning to grow. Although imperial China lacked a system of IPR, IP protection is not completely anathema to Chinese culture. Taiwan, for example, was the third largest foreign region applying for patents in the United States in 2001 (after Japan and Germany).

The prospects are not, therefore, completely bleak. Although piracy is an enormous challenge, Chinese and foreign companies are investing in software and scientific development in China, frequently through science and technology parks, such as those administered by China's Ministry of Science and Technology. Chinese authorities also recognized that they are being deprived of tax revenue through piracy and counterfeiting, and that these activities erode respect for rule of law. Chinese consumers complain at least as bitterly as American companies of fake and shoddy counterfeit goods. Criminal prosecutions, although small, are also increasing. China's leadership has also taken note of many of the problems, although the focus primarily tends to be in counterfeiting and not in copyright where Chinese industry has a smaller interest. Open markets and deregulation have the unfortunate side effect of creating greater opportunities for counterfeiters and pirates to ply their wares. They may respond more quickly than police or government agencies that are not as well prepared for these types of crimes.

To address wide scale piracy and counterfeiting, a multi-faceted approach—including criminal law, civil law, government, business and non-profit organizations, as well as public outreach and international cooperation—is required. Piracy and counterfeiting are worldwide problems and international cooperation remains critical.

II. INTELLECTUAL PROPERTY AND RULE OF LAW EFFORTS

I believe that intellectual property is the most vulnerable to ineffective legal systems of all such property rights. Being intangible, it is a right that is defined by law and easily undermined by lawlessness.

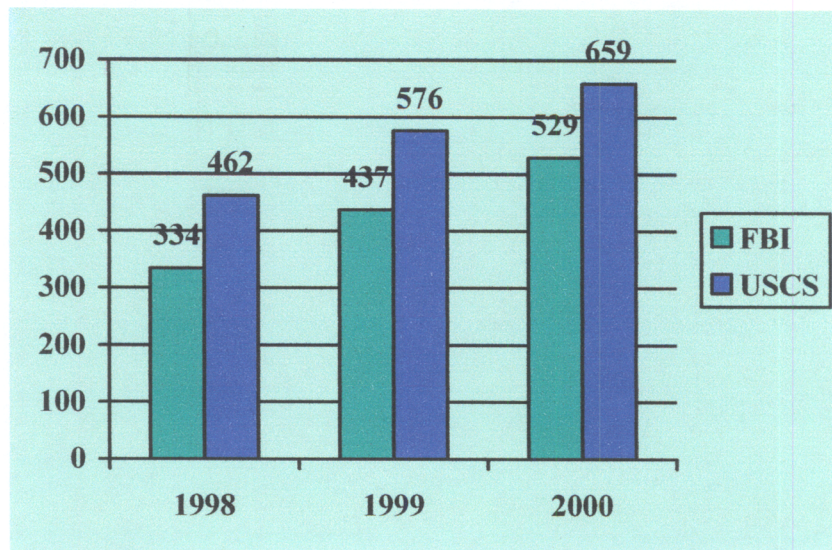
It is important to recognize that China does not lack for intellectual property laws. What China mostly needs is deterrent enforcement of its laws. China has a vast administrative apparatus which levies fines for patent, trademark, copyright, semiconductor layout design, trade secret, trade dress, defective products, illegal use of the Internet, counterfeit tobacco, counterfeit drugs, etc., all of which implicate IPRs. There are national and local laws, rules and regulations on IPRs. Courts and the procuratorate may issue their own interpretative rules. Agencies may issue their own guidance, sometimes in conjunction with other agencies. A frequent issue in dealing with IPRs in China is determining what national or local law, rule, regulation, interpretation, decision, guidance, notice, decree, order, interpretation etc. applies and is in actual effect.

On the enforcement side, the lion's share of activity is conducted by administrative agencies which have enforcement authority. According to China's TRIPS Council submission, for example,

There were 41,163 trademark law violation cases in 2001. Infringers were ordered to pay the right owners damages of RMB 3,343,400 in total and there were 86 cases transferred to criminal procedures. In respect of enforcement of the Copyright Law, in 2001 copyright administrative authorities accepted 4,416 cases in total, among which 4,306 cases have concluded with rulings. Among those concluded, 3,607 cases ended with imposing a fine upon the infringers; 633 cases ended with mediation; and 66 cases were transferred to criminal procedures.

By comparison, the actual number of civil cases was far smaller, and civil cases involving foreigners was far smaller still. In fact criminal IPR cases investigated under China's criminal copyright and trademark provisions may be a smaller number than those that are prosecuted in the United States, where piracy and counterfeiting rates are less.

US FEDERAL IP INVESTIGATIONS OPENED



Source: Computer Crime and Intellectual Property Section, USDOJ

Respect for intellectual property rights, the most vulnerable of property rights, promotes respect for rule of law and promotes development of accountable administrative, civil and criminal legal systems. While it may be theoretically possible to have a legal system that does not recognize intellectual property rights, I do not believe it is possible to adequately protect intellectual property rights in the long run without an effective and fair legal system. In the past certain U.S. efforts regarding intellectual property rights protection were criticized by some academics, such as Prof. William Alford, as "devot[ing] considerable diplomatic capital to secure concessions that fail meaningful[ly] to speak to the chief impediments to the development in China of respect for legality and, through it, of a greater commitment to the protection of intellectual property rights." (To Steal A Book Is An Elegant Offense, p. 118). I believe such criticism is misguided.

The relationship between IP and rule of law was recently underscored at a roundtable on intellectual property rights held at the U.S. Embassy in Beijing in October 2002, where Ambassador Randt, addressing industry concerns over national treatment and corruption in China's IPR system, clearly stated that the issues are intertwined in the Embassy's mission to promote both human rights and protect U.S. intellectual property rights. Industry also recognizes that without effective rule of law, intellectual property rights will not be accorded the full protections they are

due. As an industry spokesman noted in hearings held by USTR in preparation of the December 11, 2002 Report:

[W]e all recognize that this is a process that will take time, and patience. The institutional, legal, and regulatory changes demanded of the Chinese are extraordinary, reaching in most corners of their economy, and complicated further by a highly decentralized administrative structure covering a vast, diverse country.

The TRIPS agreement itself, as well as the Working Party Report of China's WTO commitments, contains the seeds of these rule of law issues, in such key issues as transparency of rulemaking and judicial decisions, and in notions of proportionality of criminal offenses. These issues in fact, are a key part of this Commission's mandate. See P.L. 106-286, Sec. 302(c) 2-4, 6. Legal systems that administer light administrative penalties against IP criminals, while imposing harsh sentences on young people distributing DVDs on bicycles, corrode respect for rule of law and for IPR. While campaigns against piracy can result in focused gains for IPR, long-term systemic changes likely depend on an effective legal system. Proportional penalties imposed against violators by an independent judiciary, serve rule of law and IPR needs. By addressing issues such as rights of accused in criminal IPR cases, or the need for administrative transparency in rulemaking and review of patent and trademark applications, both rule of law and IPR protection objectives are served.

As we seek more effective enforcement of China's IPR laws, civil, criminal or administrative, we must also be mindful of other U.S. Government policy goals in promoting a legal system that meets international standards of fairness. These goals are complementary, not inconsistent. Effective law enforcement can be a double-edged sword. With China's increase in domestic rights holders, there is a growing likelihood that U.S. companies may find themselves on the wrong end of enforcement actions, frivolous or otherwise. Thus, it is in the interest of the U.S. Government, as well as U.S. companies doing business in China, to promote the development of a legal system in China that fairly protects the rights of all parties and has reliable fact-finding processes.

In discussing enforcement of intellectual property rights with Chinese colleagues I have been especially heartened by their interest in such matters as: sentencing guidelines for the proportionate and predictable determining of criminal penalties; discovery and pre-trial exchange of information; role of specialized courts in intellectual property enforcement; authority of courts to implement international obligations, such as the TRIPS agreement or to "fill in the gaps" in administrative rulemaking; standards for issuing preliminary injunctions or ex parte measures; protections against abuse of intellectual property rights, or against abuse of civil or administrative process; responsibility of lawyers to the judiciary; the role of lawyers in protecting confidential information in patent or trade secret cases; increasing technical legal exchange; the role of intellectual property in promoting technology development and transfer; protecting content over the Internet and protecting computers against hacking; ensuring that local administrative agencies and their enforcement efforts comply with national standards; and related issues.

I can also say on a personal note, that Chinese counterparts respond favorably to constructive criticism of their IPR system, and that we have an obligation on behalf of our rights holders and in the interest of the Chinese people to constructively raise these important issues at every relevant venue.

III. USG EFFORTS TO PROMOTE INTELLECTUAL PROPERTY PROTECTION

Many industry representatives would like to see a more active U.S. presence on intellectual property matters in China. There have been many such efforts under way by both the private sector and the government. All major U.S. IP trade associations are active in China to some extent. Many NGOs which have a general rule of law orientation have also recognized the intersection between IPR and rule of law issues. Franklin Pierce Law School ran a summer institute on IPR with some USG assistance at Tsinghua University this past summer. George Washington University Law School and John Marshall Law School also have extensive contacts with Chinese IPR students and experts. The Quality Brands Protection Committee, the United Nations Development Program, the copyright industries such as the Motion Pictures Association, and others have also run successful IPR programs. There may be many other programs of which I am not as aware. I have already mentioned Ambassador Randt's very successful roundtable in which various industry groups raised their concerns over China's IPR environment; the Embassy, USTR and other agencies, are also involved in other efforts to enhance the IPR position in bilateral discussion. The Embassy in Beijing has also recently developed an action plan to help

address IPR issues, which should help to more successfully protect and promote US interests in China.

Among recent U.S. Government programs, the USPTO, in conjunction with the International Intellectual Property Institute, George Washington University Law School and the Court of Appeals for the Federal Circuit hosted a number of Chinese judges this past summer at a conference on capacity building for specialized IP courts. The Commerce Department ran two IPR training programs last year in China, as well as a program on technology transfer, in addition to hosting Chinese delegations on various matters, including several from the Shanghai WTO Consulting Center or in meetings of the APEC/Intellectual Property Experts Group or at WIPO. I was privileged to be the guest of the Japan Patent Office this past December as a speaker in an IPR enforcement program it ran in Beijing.

We are looking for further cooperation with other governments and with China on such programs. Where circumstances have permitted, we have also reached out to localities, to universities and educational institutions, and to Chinese entrepreneurs. Last year, I participated in a successful program led by Deputy Under Secretary of the Technology Administration of the Department of Commerce Ben Wu on IPR with the science and technology parks administered by the Ministry of Science and Technology, which entailed reaching out to these groups.

We have the resources to deliver targeted and effective training programs. There are a number of Chinese speaking IPR experts in the U.S. Government and the private sector who are familiar with China's legal system and I believe, have been quite successful in building bridges by delivering programs quite effectively in Chinese without interpretation or translation. This approach also helps to instill greater confidence and respect from Chinese colleagues.

The European Union and European Patent Office ran a well-organized, well-funded multi-year IPR capacity building program in China which ended in December 2001. A focus of many industry groups and government organizations recently has been criminal enforcement of intellectual property, including cooperation with Chinese counterparts. Certain rule of law initiatives, such as those involving rule-making transparency by the Asia Foundation have the potential for clear collateral benefits to IPR protection. Because the TRIPS agreement itself has certain transparency obligations, these programs may also fruitfully begin their analysis by looking at international obligations and practices for transparency in an IPR context.

Because of the widespread deterrent effect which criminal prosecution has, as well as the general lack of awareness of police officers and prosecutors in many countries of IPR crimes, training law enforcement officials, including Customs officials, is of increasing importance to addressing the deficiencies in China's IP system and in advancing the rights of Chinese and Americans alike. The U.S. Sentencing Guidelines, for example, have elicited considerable interest from Chinese colleagues as they provide a reasonable, fair and proportional method for determining sentences for IPR infringers, which is consistent with international practices, and I believe also advances our needs for rule of law. It is likely this year that there will be in increased emphasis on IPR criminal issues through training and consultations with our Chinese counterparts.

Another emerging issue of some importance is protection of copyright over computer networks, especially the Internet. As we all know Internet usage in China is increasing dramatically. Copyright protection over the Internet, as well as other forms of digital issues involving copyright are important international challenges which all countries are forced to deal with, and which increasingly require international cooperation and coordination. While China's recently revised copyright law and other regulations and interpretations do consider the impact of the Internet on copyright protection, the U.S. Government would like China to fully accede to the WIPO Internet Treaties (WIPO Copyright Treaty and WIPO Performances and Phonograms Treaty) and more vigorously coordinate and enforce copyright in digital formats. I believe that training in this area, conducted by various U.S. agencies (such as USPTO, the Copyright Office, and the Department of Commerce) and private organizations is also of considerable importance.

Thank you and I look forward to your questions.

